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ORLY.OQ - Q4 2021 O'Reilly Automotive Inc Earnings Call

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## OVERVIEW:

ORLY reported 2021 sales of over \$13b, EPS of \$31.10 and 4Q21 EPS of \$7.64. Expects 2022 total revenue to be \$14.2-14.5b and EPS to \$32.35-32.85.

## CORPORATE PARTICIPANTS

**Brad W. Beckham** *O'Reilly Automotive, Inc. - Executive VP & COO*

**Brent G. Kirby** *O'Reilly Automotive, Inc. - Executive VP & Chief Supply Chain Officer*

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

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

## CONFERENCE CALL PARTICIPANTS

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**Christopher James Bottiglieri** *BNP Paribas Exane, Research Division - Research Analyst*

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

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**Scot Ciccarelli** *Truist Securities, Inc., Research Division - Research Analyst*

## PRESENTATION

### Operator

Welcome to the O'Reilly Automotive, Inc. Fourth Quarter and Full Year 2021 Earnings Conference Call. My name is James, and I'll be your operator for today's call. (Operator Instructions)

And I'd now like to turn the call over to Tom McFall. Mr. McFall, you may begin.

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

Thank you, James. Good morning, everyone, and thank you for joining us. During today's conference call, we'll discuss our fourth quarter 2021 results and our full year outlook for 2022. 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, 2020, 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 Fourth Quarter Conference Call. Participating on the call with me this morning are Brad Beckham, our Chief Operating Officer; and Tom McFall, our Chief Financial Officer. Greg Henslee, our Executive Chairman; David O'Reilly, our Executive Vice Chairman; and Brent Kirby, our Chief Supply Chain Officer, are also present on the call.

I'd like to begin our call today by congratulating Team O'Reilly on the tremendous results in the fourth quarter, which capped off another record-setting year. This year marked our company's 65th year since our founding and our 29th year as a publicly traded company, and I feel very comfortable saying it was our best year yet driven by the truly remarkable contributions of our team of over 83,000 hard-working professional parts people.

Our team's performance in 2021 was highlighted by our comparable store sales growth of 13.3% and diluted earnings per share growth of 32%. This outstanding performance is even more impressive when you consider that our team delivered these results on top of a record-setting year in 2020, when we achieved comparable sales increase of 10.9% and growth in earnings per share of 32%.

There are a number of different metrics I could provide to highlight the strength of our business, and we'll talk through many of those details in our customary updates during the call today. However, there are 2 specific numbers that I'd like to provide an incredible picture of just how much growth Team O'Reilly has generated for our shareholders over the past 2 years.

For 2021, our average store generated sales of \$2.3 million, which represents an increase of over 23% from the average store sales volume just 2 years ago in 2019. During this same time -- period of time, our operating profit dollars per store has grown by an incredible 42% as our store and distribution teams leveraged our dual market business model to drive very strong operating profit flow-through.

I want to take this opportunity to thank Team O'Reilly for your tremendous back-to-back annual performance. One of the guiding principles of our culture is our team's dedication to our customers and fellow team members, and that commitment was truly on display in 2021.

Rolling out the numbers for over the \$13 billion of sales, it can be easy to lose sight of the context of what it takes to deliver these results. These big growth numbers are made up of millions of individual interactions with our customers, where our team members constantly go the extra mile to provide the best customer service in our industry to earn our customers' current and future business.

Our team truly lived a "Never Say No" philosophy in 2021, while at the same time, consistently executing on best practices to protect the health and safety of our customers and team members and tackle head on the significant challenges brought on by the pandemic. It's taken a monumental effort, and I again want to express my gratitude for the selfless dedication, hard work and sacrifice of each member of Team O'Reilly.

Now I'd like to take a few minutes and provide some color around our fourth quarter results. Our comparable store sales for the fourth quarter grew 14.5%. From a cadence perspective, we continue to see steady trend of elevated sales levels throughout the quarter, continuing the consistent broad-based strength we've experienced since the second quarter of 2020. As a result, our sales results were fairly consistent throughout the quarter, with December being the strongest month on a 2- and 3-year stack basis.

We've continued to see solid sales volumes. The results thus far in 2022 have been impacted by the Omicron variant and by some inclement weather given choppiness in certain regions of the company -- or country, rather. I'll spend more time on this in a few minutes on our sales outlook for 2022, but I'd like to add that we're always pleased to see this type of harsh weather as the wear and tear it inflicts on vehicles benefits us throughout the year.

Our comparable store sales results were driven by somewhat stronger growth on the professional side of our business, which continues to trend -- which continues the trend we experienced in the second and third quarters. However, our DIY business was also very strong in the fourth quarter and our expectations against difficult compares from the prior year.

For the quarter, we were very pleased to see the solid growth on both average ticket and comparable ticket counts in both our professional and DIY businesses, with average ticket being the larger contributor. The average ticket growth was aided by heightened inflation with the benefit we

realized from same-SKU selling prices landing in the high single digits. However, we continue to be pleased to see growth in average ticket beyond the positive impact of same-SKU inflation driven by the long-term increased complexity of automotive technology.

Demand in our industry has remained very resilient for the past 2 quarters, even as price levels and the broader economy have risen sharply. The acquisition cost increases we saw in 2021 were consistent with the cost pressures experienced across the automotive aftermarket, and the industry continues to be very rational in passing through the inflationary pricing.

Finally, even though average ticket was the larger contributor to our comparable store sales for the quarter, we also believe we're pleased to capitalize on solid ticket count comps, which were positive for both the professional and DIY businesses. We've been encouraged by the stability of our customer traffic, especially as we continue to move further past the major macro-level demand tailwinds provided by the government stimulus. We believe we're very clearly benefiting from market share gains and an increased willingness of customers to invest in their existing vehicles.

Next, I want to transition to a discussion of our 2022 sales guidance as well as our 2021 gross profit performance and outlook for gross profit for 2022. As we disclosed in our earnings release yesterday, we're establishing an annual comparable store sales guidance for 2022 at the range of 5% to 7%. Our expectations are to generate positive comparable store sales growth on both sides of our business, with stronger growth on the professional business.

This range and corresponding expectations for the coming year are higher than we can remember ever providing in our initial annual guidance. So I want to spend some extra time to provide color on the basis for our forecast relating both to our general outlook for the coming year as well as our planned strategy to further invest in pricing on the professional side of our business.

To begin, from a macro perspective, we remain very confident about the health of the automotive aftermarket and believe the stable, robust growth trends experienced in our industry are indicative of ongoing core underlying strength. The value proposition for consumers to invest in their existing vehicles remains very strong driven by scarcity of new vehicle supply, high demand for used vehicles, and the quality of engineering and manufacturing of vehicles currently on the road, merits higher mileages.

Our industry history has proven that time -- in times of economic uncertainty motivate consumers to take more cautious financial outlook and allocate additional share of their wallet to maintain their existing vehicles. We believe this has been a positive for our business since the onset of the pandemic and that this value proposition will continue to support solid demand in our industry. We are also encouraged by the resilience of the strong sales trends in our business we've moved -- as we move further past the injection of government stimulus into the economy and believe that economically, consumers remain relatively healthy with employment increasing and miles driven steadily recovering.

Beyond this positive macroeconomic backdrop, it is also clear to us that our extremely strong sales results are driven by significant share gains, with our outperformance, the direct result of significant competitive advantages afforded by the strength of our business model and supply chain.

For the DIY side of our business, we anticipate delivering generally stable to slightly negative ticket counts, with the headwind coming from lapping the positive impact of governance stimulus in the first half of 2021 and expected pressures from increased prices. We remain cognizant of the impact of sustained inflation on the economically challenged DIY consumers, who have just historically deferred noncritical maintenance and traded down the product value spectrum as prices dramatically increased.

We expect this pressure to ticket comp counts to be more than offset by increased average ticket as our forecast includes an assumption of mid-single-digit same-SKU inflation. The anticipated benefit from same-SKU inflation does not include significant incremental increases in price levels from this point forward in 2022, consistent with our historical approach to issuing guidance. Our projection reflects the static prices from current levels with expected benefit of same-SKU inflation being stronger in the first half of the year as we compare price levels that ramp throughout 2021.

From the professional side of our business, our guidance expectations assume robust growth in ticket counts supported by 4 factors: the stronger economic resilience of the end-user customers on this side of the business; incremental improvement in miles driven from consumers generally

returning to an in-person work post pandemic; the long-term industry demographic trend for faster growth on the professional side of our business; and anticipated accelerated growth from the professional pricing initiative, which I will discuss next.

Throughout our history, we have been steadfast in earning our professional customers business by providing excellent customer service from highly trained professional parts people with rapid access to industry-leading inventory at competitive prices. This unwavering commitment to customer service has allowed us to drive exceptional value for our customers and capitalize on competitive advantages to earn a pricing premium in many of our markets. Our service over price philosophy remains unchanged, but we believe we have an opportunity to accelerate our professional share gain through targeted competitive adjustments to our professional pricing strategy.

The past 2 years in the automotive aftermarket have been very turbulent, characterized by volatility in customer demand as a result of the pandemic, significant supply chain shocks and an evolving competitive landscape. These factors have been more disruptive on the do-it-for-me side of the business, which remains very fragmented and where the ability to respond to challenging environments has differed significantly between market participants. Against this backdrop, we have been very successful in gaining professional market share and growing substantially faster than the overall market through the strength of our industry-leading inventory availability, tiered distribution and hub network and world-class professional parts people.

However, we believe that the current disruptive environment presents an opportunity for us to enhance our competitive positioning and leverage our competitive advantages to drive accelerated long-term market share gains. Over the course of the past few quarters, we've tested several professional pricing strategies in multiple markets. We've been very encouraged by the results of our testing. And after dialing in our strategy, we rolled out the professional pricing initiative company-wide at the beginning of February.

For 2022, we expect to see a meaningful benefit to our professional customer comps from share gains, which we've incorporated into our comparable sales growth expectations. The professional pricing initiatives will pressure our gross margin rate, which we have also incorporated into our gross profit guidance. While we continually adjust pricing by location, by customer and by product line to reflect changing market conditions, we believe the professional pricing initiative we've put in place appropriately positions us to enhance the value proposition we offer our professional customers and solidify our position on the top of the call list for 2022 and beyond.

Next, I'd like to provide some color on our fourth quarter gross margins and additional details supporting our full year 2022 guidance. Our fourth quarter gross margin of 52.7% was a 66 basis point improvement from our fourth quarter of 2020, which exceeded the expectations we discussed on the third call -- third quarter call. For the full year, gross margin also came in at 52.7%, which was 23 basis points higher than last year and at the upper end of our guidance range instead of the bottom half of the range as previously expected. The principal driver of the better-than-expected performance was lower-than-expected distribution cost. As we've discussed on previous calls, our distribution infrastructure is facing inefficiencies due to extremely high sales volumes, the difficult labor environment and global logistics challenges. While we continue to take targeted actions in the fourth quarter to respond to these pressures, we did not incur the level of incremental expense that we had anticipated.

For 2022, we expect gross margin to be in the range of 50.8% to 51.3%. The year-over-year pressure to our gross margin rate is driven by the impact of our professional pricing initiative, a reduced LIFO benefit and a headwind from higher mix of professional business, which we expect to grow faster than DIY. We expect these headwinds to be partially offset by leverage of our distribution cost as supply chain conditions begin to normalize.

Before turning the call over to Brad, I'd like to highlight our fourth quarter earnings per share increase of 41% to \$7.64 with a full year 2021 increase of 32% to \$31.10. For 2022, our guidance is \$32.35 to \$32.85, representing an increase of 5% versus 2021 at the midpoint. After delivering earnings per share growth of 32% in both 2021 and 2020, our forecasted annual increase for 2022 diluted earnings per share represents a 3-year compounded annual growth rate of 22% and is a testament to the historical results our team has been able to generate and repeat through consistent excellent execution.

To wrap up my comments, I want to again thank Team O'Reilly for an outstanding year. Your dedication to living out our culture and taking care of our customers every day drives our continued success.

I'll now turn the call over to Brad Beckham. Brad?

**Brad W. Beckham** - O'Reilly Automotive, Inc. - Executive VP & COO

Thanks, Greg, and good morning, everyone. I want to begin my comments today by echoing Greg and congratulating Team O'Reilly on another amazing year. After our record-breaking year in 2020, we came into 2021 knowing just how difficult it was going to be to sustain that same level of performance. However, our team once again proved they were up to the challenge and generated even more impressive growth in 2021. The core driver of our success is our team's relentless focus on providing excellent customer service, and we are very excited about the opportunities we have in front of us in 2022.

Greg previously discussed our strategic professional pricing initiative, but I want to add one more point before we move on to the rest of my prepared comments. Anyone who has participated in our earnings calls or attended our Analyst Days for any length of time has heard us say on multiple occasions that price is not the most important factor on the professional side of the business and that you cannot win sustainable business solely on price. We want to be very clear that this rule still holds true for our business and our industry. We strongly believe that the lion's share of the professional business in the marketplace is, one, day in and day out through exceptional customer service and rapid inventory availability.

However, we believe we can generate solid long-term returns by further investing in professional pricing. As an important part of our professional pricing initiative, we are intentionally not positioned as the lowest-price competitor in each market, and our store and sales teams remain as committed as ever to earning our customers' business by out hustling and outsourcing our competitors. Our team fully realizes that business won with price alone is easily lost to a lower price, a competitor may decide to offer. This initiative is geared to position us more quickly to gain professional market share based on all the services we offer, along with a very competitive price.

Now I'd like to take some time to covering our SG&A and operating profit performance in 2021 as well as our outlook for 2022. For the fourth quarter, we generated an impressive increase in operating margin of 165 basis points and operating profit dollar growth of 27%. For the full year, we generated a 21% increase in operating profit dollars, yielding a new annual record of 21.9% operating margin. This increase in operating profit results for 2021 was driven by our team's ability to generate exceptional comparable store sales results of 13.3% while limiting our per-store SG&A growth to under 9%. The result was improved leverage of SG&A expenses of 81 basis points.

Our 2021 results are even more impressive considering we delivered these results on top of leveraging SG&A by 263 basis points in 2020. The dollar growth in our SG&A spend per store in 2021 was significantly higher than our typical growth in operating expenses driven by expenses incurred in store payroll, incentive compensation and variable operating expenses to support our sales growth. Over the last 1.5 years, our focus has been to match the tremendous opportunities we've had to gain share and drive very strong sales growth by delivering on the excellent customer service standard that is at the core of our business, all while micromanaging our expense structure.

The result has been an enhanced level of profitability that candidly has exceeded our previous expectations for our ability to execute our model effectively at this level of SG&A productivity. However, our top line growth for the last 7 quarters has been both robust and remarkably consistent. This stability in strong sales volumes, coupled with high fixed low-variable cost structures for our stores to generate very favorable leverage for our business model. As we capitalize on lessons learned as we've navigated record high sales and productivity gains and look forward to 2022, we are more confident than ever that our seasoned experienced teams will continue to be able to execute at this step change of increased profitability.

Our estimated per-store SG&A reflects our confidence in our ability to effectively control expenses moving forward. Our teams have demonstrated this ability to leverage SG&A even as we have faced significant wage rate pressures. Our SG&A expectations for 2022 include continued pressure from inflation and wage rates at trends consistent with what we saw in 2021, more than offset by efficiency gains, leverage on fixed costs and incentive compensation planned at target levels.

For 2022, we estimate per-store SG&A will grow by approximately 2.5%, which is solidly below our comparable store sales we expect to generate. As always, our top priority is to ensure we are providing excellent customer service, enabling us to develop long-term, loyal customer relationships.

Based upon the pressure to gross margin Greg outlined earlier, partially offset by improved SG&A leverage, we expect operating profit to decline between 80 and 130 basis points from 2021's phenomenal results. However, we expect operating profit dollars at the midpoint of our guidance

to increase approximately 2.5% and our operating profit guide of 20.6% to 21.1% of sales brackets our 2020 operating profit, which represented an all-time high for our company before we expanded the record by another 100 basis points in 2021.

Our capital expenditures for 2021 were \$443 million, which was lower than our typical capital spend and below our original plan going into 2021. The lower CapEx was driven by a few different factors, including a heavier weighting of leased versus owned stores, the delay of certain expenditures limited by constraints on availability of vehicles and equipment and the timing of certain store-level strategic initiatives that had to be pushed back as our teams prioritize supporting the current strong sales volumes.

As we set our expectations for 2022, our plan is to deploy capital for the initiatives that were delayed in 2021 as well as support new store and DC development to support our long-term growth strategies in the U.S. and Mexico. For 2022, we are setting our capital expenditure guidance at \$650 million to \$750 million. We have also established a target of 175 to 185 net new store openings.

Outside of our new store and DC development, we have also identified several exciting projects and initiatives in 2022 to enhance the service we provide our customers and improve our efficiency to drive strong returns. Our CapEx guidance includes planned investments in DC and store fleet upgrades; store projects to enhance the image, appearance and convenience of our stores; as well as strategic investments in information technology projects.

Inventory per store at the end of 2021 was \$637,000, which was down 2% from the end of last year. As we've discussed on previous calls during the course of 2020 and 2021, our intent has been to aggressively add incremental dollars to our store-level inventories. During the strong sales environment the past 7 quarters, rolling out the full scope of these initiatives has had to take a backseat to the day-to-day replenishment needs of our stores. We still see significant opportunity to build upon our industry-leading parts availability, and our plan for 2022 includes the deployment of additional inventory in our store and hub network above and beyond our normal new store and typical product additions.

As a result of this plan to catch up on delayed initiatives for 2022, we are planning our per-store inventory to increase over 8%. This level of inventory growth is significantly above our historical run rates and is driven in part by our focus on meeting the extremely strong sales demand in a supply-constrained market environment. Our ongoing inventory management is geared to deploy the right inventory at the optimal position within our tiered distribution network and includes continual adjustments to pushout and pullback inventory to achieve this objective. However, our overriding goal is to have the best local inventory offering, and that priority drives how we manage our inventory and, in turn, is the primary reason for the higher level for 2022.

Before I turn the call over to Tom, I want to once again thank Team O'Reilly for their dedication and hard work in 2021.

Now I'll turn the call over to Tom.

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

Thanks, Brad. I'd also like to congratulate Team O'Reilly on another outstanding year.

Now we'll take a closer look at our fourth quarter results and provide some additional guidance for 2022. For the quarter, sales increased \$463 million, comprised of a \$398 million increase in comp store sales, a \$56 million increase in noncomp store sales and a \$9 million increase in noncomp nonstore sales. For 2022, we expect our total revenues to be between \$14.2 billion and \$14.5 billion.

Greg covered our gross margin performance earlier, but I want to provide additional details on our positive LIFO impact. For the full year 2021, the LIFO impact was \$80 million compared to \$11 million in the prior year. As a reminder, the positive LIFO impact is a byproduct of the reversal of our historic LIFO debit. Since 2013, due to negotiated acquisition price decreases, our calculated LIFO inventory balances exceeded the value of our inventory at replacement costs, and we elected the conservative approach to not write up inventory value beyond the replacement cost.

As a result of this accounting, we've seen a benefit from rising costs and price levels via the sell-through of lower-cost inventory purchased prior to the recent cost increases. However, during the third quarter of 2021, our LIFO reserve flipped back to a credit balance as a result of inflation and

acquisition costs. And moving forward, we expect to be back to typical LIFO accounting and no longer valuing inventory at a lower replacement cost. As a result, we anticipate a limited benefit of less than \$10 million in 2022 for the final sell-through of the remaining lower-cost inventory, which creates a headwind to our gross margin rate.

Our fourth quarter effective tax rate was 19.4% of pretax income, comprised of a base rate of 20.4%, reduced by 1% benefit for share-based compensation. This compares to the fourth quarter of 2020 rate up 21.4% of pretax income, which was comprised of a base tax rate of 21.8%, reduced by a 0.4% benefit for share-based compensation. The fourth quarter of 2021 base rate as compared to 2020 benefited from a higher level of renewable energy tax credits, as a result of the timing of these projects, which was in line with our expectations. For the full year, our effective tax rate was 22.2% of pretax income, comprised of a base rate of 23.5%, reduced by 1.3% per share-based compensation. For the full year of 2022, we expect an effective tax rate of 23.2%, comprised of a base rate of 23.7%, reduced by a benefit of 0.5% per share-based compensation.

We expect the fourth quarter rate to be lower than the other 3 quarters due to the expected timing of benefits from renewable energy tax credits and tolling of certain tax periods. These expectations assume no significant changes to existing tax codes. Also, variations in the tax benefit from share-based compensation can create fluctuations in our quarterly tax rate.

Now I'll move on to free cash flow and the components that drove our results and our expectations for 2022. Free cash flow for 2021 was \$2.5 billion versus \$2.2 billion in 2020. The increase of \$359 million or 16% was driven by an increase in operating income and a higher reduction in net inventory in 2021 versus the prior year. For 2022, we expect free cash flow to be in the range of \$1.3 billion to \$1.6 billion, with the year-over-year decrease primarily due to increased net inventory investment and increased CapEx, as Brad previously outlined.

Our AP-to-inventory ratio at the end of the fourth quarter was 127%, which set an all-time high for our company and was heavily influenced by the extremely strong sales volumes and inventory turns in 2021. We anticipate our AP-to-inventory ratio to moderate off of this historic high as we complete our additional inventory investments and sales growth moderate. Our current expectation is to finish 2022 at a ratio of approximately 120%.

Moving on to debt. We finished the fourth quarter with an adjusted debt-to-EBITDA ratio of 1.69x as compared to our end of 2020 ratio of 2.03x, with the reduction driven by the significant growth in EBITDAR during 2021 and a decrease in adjusted debt, including the redemption of \$300 million of senior notes in the second quarter. We continue to be below our leverage target ratio of 2.5x, and we will approach that number when appropriate.

We also continue to execute our share repurchase program. And for 2021, based on the strength of our business, we were able to repurchase 4.5 million shares at an average share price of \$545.78 for a total investment of \$2.5 billion. Subsequent to the end of the year and through the date of our press release, we repurchased 0.3 million shares at an average share price of \$660.23. We remain very confident that the average repurchase price is supported by the expected future discounted cash flows of our business, and we continue to view our buyback program as an effective means of returning excess capital to our shareholders. As a reminder, our EPS guidance for 2022 includes the impact of shares repurchased through this call but does not include any additional share repurchases.

Before I open up our call to your questions, I'd like to thank the O'Reilly team for their dedication to our company and our customers. Your hard work and commitment to excellent customer service continues to drive our outstanding performance.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question is from Scot Ciccarelli of Truist Securities.



**Scot Ciccarelli** - *Truist Securities, Inc., Research Division - Research Analyst*

I think we can appreciate that price isn't the most important factor in driving a customer's decision. But I guess my questions are, number one, why are we making these price investments now, as in what has changed? And then number two, why couldn't we see this round of price cuts become another set of price cuts at some point in the future, potentially threatening one of the key investment pillars of this vertical?

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

Yes, Scot, this is Greg. I'll take that one and then see if Tom and Brad may have something to add to it. As to -- first of all, I want to reiterate what you said. Our philosophy hasn't changed. We always lead with service. Service is most important followed by inventory availability and then price.

As far as why now, when you look at the past couple of years, we've been through 2 years of inflation, price increases. We've seen rising prices. We've seen supply chain disruption. And I think we've performed better than a lot of our competitors over the past couple of years, especially our smaller competitors.

When you look at the professional side of our business as a whole, as you know, it's very, very fragmented. There's a lot of players out there on that side of our business, some of which are the large national players, some of which are the smaller WDs and 2-steppers. We compete against each of those every day in every market that we operate in. So we felt like coming off of a couple of years of inflation and supply chain disruption, again, where we've performed well, and the anticipation that some of the supply chain disruption may moderate in the back half of the year, timing was right to implement this change.

We -- what we did here is really no different than what we do day in and day out with our pricing team. Our pricing team constantly monitors pricing on both sides of our business and makes tweaks to pricing at both the professional and the DIY level across our customers. And this initiative specifically targets our DIFM customers and -- just we feel like this will enable us to take additional market share on that side of the business. So that's why now.

Brad, did you want to add anything to that or take the second part of the question?

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - Executive VP & COO*

I would just really echo what Greg said, Scot, in terms of you as well as anybody on the call knows how fragmented the DIFM side of the business is. And you know how really little share when you add up us and our public competitors on the -- really the addressable DIFM share in the United States is still very small. And so I would just reiterate really what you said and what Greg said that it's so important for us to convey that this is not a change in terms of our focus. We have built our company on service. We have built our company on relationships. And as you know, we built our company on the professional customer, and retail came later. And so this is not abandoning all the things that got us where we are and the things that are going to get us into the future.

To your point on the timing of it, Greg had some great comments there. And the other thing I would say, Scot, is with everything that our industry and really everybody in the world has been through the last couple of years, especially our professional customers. Whether it be a shade tree mechanic to an independent garage to the national and regional accounts, we have not backed off of being out there, calling on them, meaning actually visiting their shops day in, day out, week in, week out. And an opportunity that we saw the last couple of years is our shops are telling us, I mean, our service is where it needs to be. Our teams in the stores, everything that you know we've done with inventory availability.

And when it comes to the independents out there and the 2-step-type model competitors as well as some of the specialty-type competitors that maybe just focused on a couple of categories, we just simply see an opportunity from our sales team and in the field to go out and with a rifle approach, target those areas; and with existing customers that may be buying a certain amount from us, maybe buying a certain amount from an independent in another amount from a true specialty company, consolidating that customer and truly getting a first and only call, and we feel very good about that.

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

And Scot, just on your -- the second part of your question, I want to reiterate that this is a targeted approach. This is a very scientific approach we're taking. This is not across the board. This price enhancement was done by category, by SKU. And we still feel like that based on our performance, our supply chain strength, that we can still charge a premium to our professional customers. So we do not feel like this is a race to the bottom. We do not feel like we are low-balling cost. We're just getting competitive with some of our competitors out there in the market to take additional market share.

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**Operator**

Our next question is from Christopher Horvers of JPMorgan.

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

I'll be the second to ask about the pricing. I thought that was a great answer. I just want to focus on a couple of things. So first, going back to the introductory comment that you intentionally try not to be the lowest price in the market because you have the leading service model. Do you still expect that to be true going forward? And if some of this is just you're not passing along the inflation that you're experiencing, what's the risk that you actually lower the market -- lower the low range of the market price range? Do you know what I mean?

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

Yes, Chris. On the first, we absolutely feel like that this makes us competitive in the marketplace. And as far as lowering, again, we are not doing this to be the lowest price in the marketplace. We feel like that there is tremendous value in the services that we provide and the relationships.

You have to remember the professional customer, while price is important, we're not seeing price is not important, what's more important to that professional customer is the relationship we have with them, the inventory availability that we have and our consistent performance and ability to get that part to them timely so they can complete the jobs they're working on. Our professional customers will always prioritize that over price, again, assuming that we're competitive on price. So we feel like this move will enable us to take additional market share both from existing customers and gain market share from customers we may not be getting business from today.

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

Chris, to address your second part of your question, you're absolutely right. In many cases, due to the significant inflation -- same-SKU inflation, it varies across product line. In many cases, this isn't reducing The Street price. It's just not taking that acquisition increase to The Street in price.

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

Got it. And then as a follow-up, you talked about sort of targeting sort of product lines and categories where you see some specialty players having share. So can you maybe expand on that? Is this targeted at share with like national accounts? Is it up and down The Street mechanics? And to what extent it is something like, I don't know, like fuel injection lines that maybe have a certain degree of specificity where that specialty player provides differentiated sort of product?

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

Well, Chris, this is Tom. I'm going to start with the answer. So you know that the answer is going to be we're not going to give that. But I really want to make sure that -- we're talking about a broad pricing strategy. We don't communicate the details of our pricing strategy. A lot of science, a lot

of work goes into it, a lot of history. So we're not going to get down into the details of what the program is. But in general, I'll turn it over to Brad for his comments.

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**Brad W. Beckham** - *O'Reilly Automotive, Inc. - Executive VP & COO*

Yes, Chris, I think what's important to talk about here is this isn't a, again, new strategy or initiative that's focused on one customer group. Again, this is going to -- this is our commitment to everybody from the Shade Tree to the independent garages to the regional players to the national accounts. And Chris, as you know, we still have a gap in footprint in a part of the -- Northeast part of the country that keeps us from really being the first call for some of the national guys from a matchup standpoint.

But what I would say, again, to remember is that while we have new opportunity for new customers always, one of the things that we really like about this is our existing customers that are buying a piece from us, maybe a piece from our public competitors, a really big piece from the independents and then another piece of their monthly purchases from a specialty company. And we're already delivering to these shops. In some cases, we're delivering part of the job that maybe they had to get another item from somewhere else. And so we just see tremendous opportunity. And our customers are telling us that with our inventory availability, our service, our people, if we can make some adjustments there, we really have a huge opportunity to turn into the first and only call for those garages.

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**Operator**

Our next question is from Bret Jordan of Jefferies.

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

I'll jump from pricing to supply chain. Could you talk about maybe the cadence of supply chain disruption? Or I think in prior quarters, we talked about some categories specifically being really hard from an import or production standpoint. Could you talk about how you saw your availability of inventory in the fourth quarter?

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

Yes, Bret, I'll start that, and then I'll see if Brent has anything to add because he lives that day in and day out. We have seen improvement. And when you talk about supply chain constraints over the past several months, it's bigger than just supply and demand. There's been a lot of facets to that.

I would say that it has improved from overseas. Container availability has improved. We still have some port challenges. We still have some targeted suppliers, primarily suppliers that are operating in smaller markets domestically that are having -- still having some labor issues. We got some raw material challenges that some of our suppliers are having.

Overall, I would tell you that our fill rate from our DCs to our stores has improved. I would tell you that our in-stock position at our stores has and continues to improve, and most of our suppliers overall fill rate has improved. Now that said, we still have some suppliers that are challenged, and we still work with those. I know Brent and his team, some of our suppliers, they're meeting with weekly or even multiple times a week to work through those constraints. Brent, did you want to add anything to that?

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**Brent G. Kirby** - *O'Reilly Automotive, Inc. - Executive VP & Chief Supply Chain Officer*

Yes. Bret, Greg gave a good summary. I mean, I think we are seeing general trends of improvement, as he alluded to. We still have some spotty suppliers that we're working more closely with than others. But generally, we're encouraged by what we're seeing, and we anticipate that improvement to continue, hopefully, as we work through the first half of the year and into the back half of the year.

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

Okay. Great. And my follow-up question is going to be on price. But you said you're going to be competitive in the markets. And I guess, given your higher service levels and historically higher in-stocks than peers, can you be priced still above those peers just given the other values you offer in the transaction? Or are you thinking that by competitive, do you mean you'll be priced on a dollar basis in line?

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

No. Bret, we still feel like we can be priced at a higher price point than our competitors based on the services we provide, which has been our historic stance on this. Tom, did you...

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

The thing that I'd point to, Bret, is we have a wide range of competitors, and Brad touched on them earlier. Some compete solely on price. A lot of specialty one-line suppliers, they get business by being absolutely the lowest priced, and that's not our business model. So when we say we're going to be more, we're going to be within a competitive range. Obviously, it depends on how expensive the part is. If it's \$1 part, you're \$1 over, that's a heck of a lot. If you're \$1 over and it's a \$100 part, that's a different, different thing.

And what we got to remember is the biggest cost for professional installers is they're (inaudible). And that ability to turn those [bays] is what turns their profit. So we want to make sure that we're pricing holistically for the quality of the product, the availability of the product, the team that we offer, services that we offer. So we look at it in aggregate. But there is always going to be someone, and we talked about it in our prepared comments, who'll be the lowest price. And if that's how you sustain your business, if somebody comes along, decides to drop the price, you're going to be in trouble. And we want to have a relationship and a partnership with our professional shops that help them make money over the long term.

**Operator**

And our next question is from Greg Melich of Evercore ISI.

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

I guess I'd love to go to the guidance on the top line, the 5 to 7 comp guide. I think you said it was mid-single-digit inflation in that. And assuming that mix is still positive, is it fair to say units will be flat or even slightly down this year?

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

So 5 to 7 -- that mid-single digit within the 5 to 7 was specifically for the DIY side of the business, and we would expect it to be sure on the ticket count there. Because of the price -- the professional price initiative, we won't see as robust an increase in same-SKU inflation on the professional side. So we need to generate a meaningful increase in average ticket on the professional side. So that -- your numbers are right, but that was just for the DIY side.

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

Got it. And then I guess the follow-up linked to that is, if we look at the gross margin rate in your guidance this year versus last year, I guess, LIFO is maybe 50 bps. Could you give us how much of it is the pro pricing initiative versus just the normal mix change you would expect to pro outperformance?

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

So Greg, you've picked up on a good point. Part of it is going to be just a mix shift. As professional grows faster than DIY because they're buying on volume, their gross margin is lower. We also have the benefit of the supply chain. I would tell you that the professional pricing is larger than LIFO, but we're not going to get into parsing out because the next we'll be talking about our distribution costs, and that's something we just don't do.

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**Operator**

And our next question from Michael Baker of D.A. Davidson.

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**Michael Allen Baker** - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

I wish I could ask something not about pricing, but this is the topic. So -- what do you expect the competitive response to be? Do you have any precedent for doing something like this? And what have you seen competitors do? And I guess, related to that, just to be clear, who is -- who do you think you're taking share from, from this initiative? It sounds like it's more about taking share from smaller players rather than your big public competitors, but I just wanted to confirm that.

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**Brad W. Beckham** - *O'Reilly Automotive, Inc. - Executive VP & COO*

Mike, this is Brad. I'll jump in there and see what Greg and Tom have to say about it. But on -- I'll answer the share question. And on the share, it's hard a little bit to always tell exactly where it's coming from. But I would say that what we're seeing, it's more from the -- more of the mid-tier, maybe the mediocre or maybe the weaker, independent competitors that have struggled the last couple of years with supply and things like that.

Mike, as you know, as good as anybody, I mean, we have tremendous public competitors that we have the utmost respect for and then we have these regional competitors that are the strong, strong independent 2-step-type competitors that not too long ago, we were in the Ozarks and kind of our old part of the company. But I would just say on the share that we're seeing a lot of different things, but the majority of the opportunity we see is with the smaller independents and the ones that have struggled the last couple of years.

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

Yes. Mike, on what the reaction would be, I can tell you based on the test that we were in, in multiple markets before rolling this out, the reaction was obviously favorable or we wouldn't have rolled it out company-wide.

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**Michael Allen Baker** - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

When you say the reaction, so I mean the competitive reaction, not the customer reaction. So when you say the competitive reaction was favorable, I presume that means you didn't necessarily see them drop price as well?

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

That's correct, Michael. We can -- obviously, our competitors are going to do what they do with their price. I think we just want to stress that we are not setting the low market price here. So it's not as if competitors that are winning business on price alone are not going to still be the lowest.

**Michael Allen Baker** - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Understood. Makes sense. And I think all these answers clarify the strategy quite a bit. So I appreciate that.

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**Operator**

Our next question from Chris Bottiglieri of BNP Paribas.

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**Christopher James Bottiglieri** - *BNP Paribas Exane, Research Division - Research Analyst*

So my question is going to be, I guess, on inventory/inflation. So the inventory investment you spoke of plus 8%. It sounds like your guidance assumes kind of like flattish inflation, maybe even deflation for Q4 '22, I would think, with the price investments. So are you effectively just raising in-store inventory units or by year-end? And then do I have that right first? And then how do you think of the cadence of that inventory? Is it going to be pretty smooth as you throughout the year? Is it front-half loaded? Any context there would be helpful.

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

This is Tom. Let me take a shot at that one. So when we talk about 8% increase, we don't have -- and we talked about it for the last 7 quarters, we're not sitting on as much inventory as we would normally sit on because of supply constraints and because of the high volume. So part of it is to get back to where we normally would be. And part of it, these initiatives go back to our 2020 guidance. And I guess it would be the end of 2019 fourth quarter call where we had a plan to add to the hub-and-spoke network. So it's a combination of those 2 items.

When we look at how fast we can roll this inventory in, everybody in this room and everybody on our team would like to have it tomorrow. The question is, how fast can suppliers supply it? How fast can we push it through the distribution network? So this is, as Brent said earlier today, and he can add to this, this is going to be an all-year project. We're going to move a lot of units.

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

Yes. Again, Chris, this is not a new strategy. It's something we've had planned for a couple of years, but supply chain constraints and the volumes we pushed through our DCs in the last couple of years have just prohibited us from getting this inventory rolled out.

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**Christopher James Bottiglieri** - *BNP Paribas Exane, Research Division - Research Analyst*

Got you. That makes sense. And then a related question, on the LIFO, the \$10 million, is that more like kind of a Q1-ish event? Or is it -- are these slow-turning SKUs that would cause you to take that throughout the year? And then like -- yes, that's it for me.

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

A great question. That should all rolled in, in the first quarter.

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**Operator**

Next question from Michael Lasser of UBS.

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

What -- as you were laying out your plan for 2022, what did you assume that the overall industry is going to grow at in the year ahead?

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

That's an interesting question, Michael. I think what we looked at is when we look at inflation, what we're going to anniversary in same-SKU inflation. I think that's a pretty reasonable number for the industry. I think we'll be pressured more on the DIY side. Professional will continue to grow faster, more resilience to those price increases. Of course, we build our plan from product line and store up, and it's really independent of what the market is going to do. But our expectation is -- as you know, has always been that we are going to grow faster than the market.

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

Yes. Obviously, the intent of the question was to try and size how much market share you expect to get for the price investments that you're going to be making. So is there another way to frame that out? And then I'll let you answer that, and then I have one quick follow-up.

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

Okay. So there are a lot of puts and takes within what we think is going to happen with the business, both on the DIY and the professional side of the business. And we are confident that when we look at our gross margin dollars that this is going to be a winner for us. And we've rolled it out here in February, and we are very optimistic it's going to exceed our expectations.

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

And my follow-up question is, do you expect this strategy, which will weigh on your gross margin and drive market share, to be unique to 2022? Your guidance implies that your gross margin rate this year is going to get back to levels that it was last at in 2013, 2014. So what are the chances that you will have to continue to execute this pricing and investment strategy beyond '22 such that your gross margins are going to float lower even after this year?

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

Well, the thing, I guess, I would point out is that percents are nice and dollars pay the bills. So I did see a note where in 2014, the gross margin percent was the same. But I would say that we're about 98% more gross margin dollars, which is \$3.5 billion. At the end of the day, we're trying to figure out how we build a sustainable business that generates increasing operating profit dollars year-over-year. And we think that this initiative continues to move us in that direction. And after the number exercises, I'll turn it over to Greg.

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

Yes, Michael. We don't have any planned initiatives like this beyond this year. That said, as I said earlier, our pricing team consistently, day in and day out, looks at pricing in the marketplace. And we tweak the SKU up, the SKU down just to optimize our margin. So there's always changes in our pricing structure both -- on both sides of our business. But we don't anticipate future larger-scale price reductions like this.

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

Okay. So Greg, just to clarify that you expect this year, you're going to make some price tweaks away in your gross margin. And then after this, it will be normal course of business to continue with what you've done in the past?

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

That is correct.

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**Operator**

Our next question from Daniel Imbro of Stephens.

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

I'll ask one, not on pricing. Greg, I wanted to ask one just on the customer. I think you mentioned the potential for customer repair deferrals during periods of inflation or maybe economic uncertainty. Just as we head into this year, as the low-end consumer feels pressure from broader inflation, are you seeing any indication early on of repair deferrals or something that make you think that could happen this year? And is there anything like that baked into the comp guidance you've given?

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

Yes, Daniel, we call that out as we often do because historically, we've seen those changes to that lower-income consumer being one of the first things they do. We have not. We have not seen any signs of our DIY or our professional customers for that matter trading down or deferring maintenance at this point.

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

What I would add to that is we've seen pretty significant price increases. And to the extent when we look historically, when that's happened, DIY, especially on the lower end, we faced headwinds on customer transaction counts. And we anticipate some of that this year and have built that into the forecast.

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

Got it. That's helpful color. And then I can ask a follow-up on SG&A. I think SG&A per store, it looks like at the midpoint, call it, 3% to 4% increase. I guess, one, is that right? And then two, with wages being as inflationary, Tom, you mentioned efficiency benefits earlier in kind of fixed costs, but are there any other initiatives you guys are doing to keep that at such a muted pace? I think we expect there to be more SG&A growth given the wage backdrop we're seeing. So trying to understand what's driving that improvement.

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

So I think in our prepared comments, our math is around 2.5% increase. Last year, we were significantly above that, and sales were significantly above that. As Brad talked about in his prepared comments, we manage our SG&A at a micro level, especially store payroll, which is our biggest variable expense, to make sure that we're taking opportunities to gain share but not getting out over our skis. So this is based on the sales forecast. To the extent that we exceed the sales forecast, it will be higher than this. To the extent we are less than the sales forecast, you better believe it will be less than this. So more of a normal -- actually, higher than our normal run rate because our comp guide's higher than our run rate.

On the SG&A efficiencies, 8, 9 years ago, we used to talk a lot about our initiatives, then they seem to become other people's initiatives. So we tend not to go into detail on those.



**Operator**

And 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, James. We'd like to conclude our call today by thanking the entire O'Reilly team once again for their unwavering commitment to our customers and for their incredible performance in 2021. We look forward to another strong year in 2022.

I'd like to thank everyone for joining our call today, and we look forward to reporting our 2022 first quarter results in April. Thank you.

**Operator**

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

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