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## PRESENTATION

### Operator

Welcome to the O'Reilly Automotive, Inc. First Quarter 2022 Earnings Conference. My name is Richard, and I'll be your operator for today's call. (Operator Instructions)

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

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

Thank you, Richard. Good morning, everyone, and thank you for joining us. During today's conference call, we will discuss our first quarter 2022 results and our full year outlook for the remainder of 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, 2021, and other recent SEC filings. The company assumes no obligation to update any forward-looking statements made during this call.

At this time, I would like to introduce Greg Johnson.

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

Thanks, Tom. Good morning, everyone, and welcome to the O'Reilly Auto Parts first quarter conference call. Participating on the call with me this morning are Brad Beckham, our Chief Operating Officer; and Tom McFall, our Chief Financial Officer; Brent Kirby, our Chief Supply Chain Officer; Greg Henslee, our Executive Chairman; and David O'Reilly, our Executive Vice Chairman, are also present on the call.

I'd like to begin our call today by thanking Team O'Reilly for their hard work and commitment to drive another solid quarter, ensuring we deliver excellent service to each and every customer. Our team of over 84,000 dedicated professional parts people across the U.S. and Mexico continually reinforces our O'Reilly culture of excellent customer service. Their unwavering commitment to achieving such high standards and going the extra mile for our customers is key to our repeated success.

Our first quarter results were headlined by a 4.8% increase in comparable store sales, which is on top of the record 24.8% comparable store sales we delivered in the first quarter last year, resulting in an impressive comparable store sales 2-year stack of 29.6%. These top line results produced diluted earnings per share of \$7.17, which is an increase of 2% over our extremely strong first quarter of 2021 when we grew EPS by 78%, representing an outstanding 34% compounded annual growth rate when compared to the first quarter of 2020.

Now I'd like to provide some color on our comparable store sales results and what we saw on both sides of our business as we move through the quarter. I'll begin by reiterating what we noted in our press release yesterday. Historically, weather creates volatility in our first quarter from both the type and severity of winter weather at the beginning of the quarter and from the timing of the onset of spring weather, and we definitely experienced choppiness in our first quarter this year. We encountered the volatility more significantly on the DIY side of our business, which I'll cover in a few minutes, but I'll start by discussing our professional business, which is much more consistent and the stronger performer in the quarter.

In our professional business, we started the quarter with some pressure from the Omicron variant. And outside of this short period, our professional business in the quarter was consistent and in line with our expectations, with comp strongly positive in each month of the quarter. We're encouraged by the resiliency and consistency of our professional customer demand and still anticipate this side of the business to be the larger driver of our growth in 2022 as we share and consolidate the market -- as we grow share and consolidate the market. We have been pleased with the results from the professional pricing initiative we began rolling out company-wide in February. Brad will provide more color on this initiative in his remarks, but I'd like to comment that the market reaction from our competitors, thus far has been muted as expected and pricing remains rational.

Turning to the DIY business. As I mentioned earlier, we saw much more volatility during the quarter on this side of the business. Early in the quarter, in addition to the headwind from inclement weather and Omicron, we also faced headwinds to DIY traffic for macroeconomic pressures stemming from the spike in gas prices and global instability. However, over the last 8 weeks, beginning in March and stretching into the beginning of our second quarter through the call today, volumes have become more consistent, though still hampered by less than ideal spring weather as our business benefits when we see an early start to spring.

Our DIY customers also often perform their routine jobs outside of their driveways and will take advantage when warmer weather hits to catch up on the repair, maintenance and tune up items that have been temporarily on hold at the end of winter. This year, we have seen cold wet weather persist through much of spring in many of our markets. However, the corresponding impact to demand matches up with what we have historically seen in similar environments and we've been encouraged that DIY results have stabilized from volatility earlier in the quarter.

From a cadence perspective, our DIY business faced very challenging year-over-year comparisons in March, driven by government stimulus payments that -- during that month of the last year. We also faced a step-up in professional comp comparison in March due to last year's stimulus, though to a lesser degree than our DIY business. However, the cadence for total comparable store sales for the quarter levels out on a 2- and 3-year stack basis, which eliminates the pandemic and stimulus impacts, with March being in the relative strongest over this extended period of time.

The durable nature of our sales volumes, as evidenced by a 2-year stack of nearly 30%, demonstrates our team's ability to differentiate our in-store experience and service levels to the many new customers we encountered over the last 2 years and convert those new customers into repeat loyal customers.

Next, I'd like to provide some color on our ticket count and average performance. The pressure to DIY ticket counts from the volatility we experienced throughout the quarter was offset by strong growth in average ticket, resulting in flat DIY comps for the quarter. We also saw a strong benefit from average ticket on the professional side of our business, which combined with an increase in ticket count drove double-digit professional comp growth. The continued strength in average ticket is in line with our expectation and reflects the benefit from the pass-through of cost increases into selling prices. Same SKU inflation was in line with our expectation for the quarter in the high single digits.

However, we have seen additional pricing increases since we communicated our guidance outlook on last quarter's call. These additional price increases and any additional inflation moving forward will help our average ticket throughout the year but may create traffic headwinds as consumers deal with broader inflation across the economy.

Now I'd like to turn our sales guidance. Now I'd like to turn our -- to our sales guidance and full year outlook. We are maintaining our full year comparable store sales guidance to a range of 5% to 7% and total sales guidance of \$14.2 billion to \$14.5 billion. Based on first quarter results, we are currently trending below our midpoint, but where we land will partly depend on how much of the wet weather impacts we experienced in the first quarter have deferred business later in the spring. We do believe we experienced necessary harsh winter to support demand of undercurrent categories as we move through the next 2 quarters.

We also saw volatility in the DIY traffic in the first quarter that was likely driven in part by economic shocks from the spike in gas prices and global instability, and we remain cautious in how we think about the impact of macroeconomic pressures as we move forward. However, we also continue to remain confident with the broader industry backdrop with steady recovery of miles driven and increasing employment underpinning stable, robust growth trends in the automotive aftermarket. This, coupled with a strong value proposition, compelling consumers to invest in their vehicles as a result of the combination of quality engineered and manufactured vehicles capable of being driven to higher mileages and new vehicle supply constraints, elevating demand for used vehicles.

Beyond these macro factors, we remain confident in our ability to capture market share on both sides of the business through our service-driven business model and robust supply chain.

Shifting to gross margin. For the quarter, our gross margin of 51.8% was 126 basis point decrease from the first quarter of 2021 gross margin, in line with our expectations for the quarter with a decrease driven by the rollout of our professional pricing initiative. As a reminder, we began rolling out this initiative in February, so we did not see the full impact in the first quarter. But our gross margin results from both professional pricing and the higher mix of professional business was in line with our plan.

Our gross margin outlook for the full year remains unchanged at a range of 50.8% to 51.3%. Earnings per share for the first quarter of \$7.17 represents a 2-year increase over \$7.06 in the first quarter of 2021 and a compounded 2-year growth rate of over 34% compared to the first quarter of 2020. Again, I would like to thank team O'Reilly for their unrelenting focus on driving profitable growth through excellent customer service. We are maintaining our full year 2022 EPS guidance of \$32.35 to \$32.85. Our EPS guidance includes the impact of shares repurchased through this call but does not include any additional share repurchases.

Before I turn the call over to Brad, I'd like to take a moment to discuss the executive leadership transition we announced in our press release yesterday. After almost 16 years of exceptional leadership and service, Tom expressed his interest in taking on a different role with the company. Therefore, effective May 9, 2022, Tom will step down from his role as Chief Financial Officer and will continue his employment with O'Reilly in the role of Executive Vice President. And at that time, Jeremy Fletcher, our Senior Vice President of Finance and Controller, will be promoted to the position of Executive Vice President and Chief Financial Officer.

Tom has been an important part of our success during his tenure, not only providing valuable operational and financial guidance, but also by identifying and mentoring many of today's senior leaders. We are very happy that Tom will continue to be an important part of our executive leadership team, and he will retain his current responsibilities for our information technology, real estate, legal and risk management efforts. We place great importance on succession planning as an integral part of our culture, and Tom has done an extraordinary job preparing Jeremy for this new role.

Jeremy has been an O'Reilly team member for 16 years, with the last 5 years of service as Senior Vice President of Finance and Controller, and is also an exceptional leader who is well suited for the position of Chief Financial Officer. I'm very confident in his ability to help lead our company to continued success well into the future.

To wrap up my comments, I want to again thank Team O'Reilly. 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?

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

Thanks, Greg, and good morning, everyone. I would also like to thank Team O'Reilly for their outstanding efforts during the quarter. Similar to last year, we knew coming into 2022, we were facing extremely tough comparisons, but I'm extremely proud of our team's continued focus on what's next, not what's behind us. We are well aware of the opportunities in the marketplace on both the DIY and the professional fronts and are excited to continue earning our customers' business each and every day.

Our team is energized and intently focused on outthrusting and outservicing our competition. First, I would like to give some added color on our professional pricing initiative. As discussed on our last conference call, we began rollout company-wide in February, and all pricing actions associated with this initiative were completed in all of our markets during that month. Our store and sales teams immediately engaged with our existing customers as well as prospective new customers to ensure there was broad awareness of the changes we implemented.

This has generated a lot of excitement for our team and our customers. We have really just begun to see the fruits of this initiative and remain excited about our long-range opportunities to accelerate our professional customer share gains within this highly fragmented market.

As I discussed on our last call as we were rolling out this initiative, our more competitive pricing, combined with excellent customer service provides a superior value proposition, enhancing our ability to take share and generate long-term sustainable business. However, we continue to strongly believe our growth will be fueled by the same key competitive advantages of exceptional customer service and rapid inventory availability.

We are still in early innings with this initiative, but are pleased with the momentum we've generated and we'll continue to execute our proven game plan and take share in the professional market. As Greg noted, pricing in the professional market has remained rational and we haven't seen significant competitive pricing actions in response to our initiative. This lines up with what we expected since we still continue to be priced at a premium, albeit now a smaller premium to the traditional players in the professional market.

We expect to -- we expect pricing to remain rational moving forward and we'll continue to execute our long-standing practice of passing through acquisition cost increases as well as reviewing and adjusting pricing on a tactical basis to ensure we are appropriately and competitively priced in each of our markets.

Now I'd like to discuss our SG&A results for the quarter. SG&A as a percentage of sales was 31.5%, a deleverage of 78 basis points from the first quarter of 2021. As a reminder, we leveraged SG&A an incredible 450 basis points in the first quarter of 2021 and called out at that time as not being the right long-term level of SG&A expense leverage for our business.

On an average per-store basis, our SG&A grew 6.4%, which was in line with our expectations for the quarter, but above our anticipated full year run rate. Our guidance continues to incorporate a full year SG&A per store growth of approximately 2.5% with the first quarter exceeding that full year average as a result of the SG&A comparison to the first quarter of 2021.

From an inflation perspective, we continue to see wage pressure in our distribution centers and our stores, but these have been within our expectations thus far. However, we have also seen pressure from rising energy costs in the form of fuel, freight, and utilities that have been above our expectations, and it's simply too early to tell how long these cost pressures will persist within the remainder of the year. Ultimately, we micromanage our operating cost to ensure a long-term focus on building strong relationships with our customers through excellent customer service.

We will remain diligently focused on evaluating expenses to appropriately respond to the match and sales environment ongoing. That said, as I previously mentioned, we will always staff our stores with professional parts people that can and will provide top-notch excellent customer service to ensure our long-term success. Consistent with our unchanged sales and gross margin guidance, we are also maintaining our full year 2022 operating profit margin guidance of 20.6% to 21.1%.

Next, I'll provide an update on our store growth during the first quarter. We opened 52 net new stores across 25 states in the U.S. as well as 2 stores in Mexico, keeping us on pace for our plan of 175 to 185 net new store openings for the year. We remain very pleased with our new store performance and continue to be excited about our ability to attract, recruit, retain and develop outstanding teams of professional parts people and quality leadership in our new stores.

Our distribution strategy and long-term steadfast commitment to industry-leading parts availability is a key driver of our growth. Expansion of our distribution network has always gone hand-in-hand with our new store growth plans. To that end, we are very excited to announce that we have begun construction on our first O'Reilly prototype distribution center in Mexico. Our new facility is located in Guadalajara with a metro population of over 5 million people and will have a footprint of approximately 370,000 square feet. This new facility will have the ability to provide company store and job or distribution to the Guadalajara metro area and support growth in the surrounding region.

Our distribution teams are well seasoned in the design, planning and construction of new facilities, and we have been very pleased with our progress in working with our leadership team in Mexico to get this project rolling in true O'Reilly fashion. We are targeting a completion date of the first half of 2023 and continue to be excited about the growth opportunities we see in the Mexican automotive aftermarket.

As travel restrictions have eased, it's been very nice for our U.S.-based leadership team to get back in person with our outstanding team in Mexico. Our leadership teams in the U.S. and Mexico are working hand in hand to execute our store, distribution and infrastructure growth strategies in the Mexican market.

Now turning to inventory, and as we shared on our last call, we intend to aggressively add incremental dollars to our store level inventories as we move throughout 2022, seizing the opportunity to build upon our industry-leading parts availability. We finished the first quarter of 2022 with an average inventory per store of \$659,000, which was up approximately 3% from both the beginning of the year and this time last year. Our supply chain leaders and teams are working diligently with all of our distribution centers and suppliers as our supply chain still has kinks and is uneven with constraints on certain commodities and with certain suppliers. That said, we are still in line with our plans to increase per store inventory over 8% by year-end.

Before I finish my comments, I want to echo Greg and sincerely thank you, Tom, for your dedicated service the last 16 years serving as our CFO. You have been an incredible mentor to me, a partner in driving the success of O'Reilly and a great friend. I am very excited about this new chapter and continue to work closely with you to drive our performance for the remainder of 2022 and beyond. We are all very excited about Jeremy's well-deserved promotion and you've done an incredible job preparing him and the team for the future.

I want to once again thank Team O'Reilly for their commitment, hard work and dedication to excellent customer service and in turn, our great company. I am confident in our team's ability to execute on the many initiatives we have in progress to grow our company, and I look forward to a strong performance throughout the rest of 2022.

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 thank all of Team O'Reilly for their continued commitment to our customers and our success. Now we'll take a closer look at our first quarter results and review our guidance for the full year.

For the quarter, sales increased \$205 million comprised of \$144 million increase in comp store sales, a \$51 million increase in noncomp store sales and a \$10 million increase in noncomp nonstore sales. For 2022, we continue to expect our total revenues to be between \$14.2 billion and \$14.5 billion.

Greg previously covered our gross margin performance for the first quarter, but I want to briefly recap our LIFO accounting for the quarter and expectations moving forward. As we noted when we established our full year gross margin guidance in February, our LIFO reserve had flipped back to a credit balance in the back half of 2021 as a result of inflation and acquisition costs, and we are now back to more typical LIFO accounting and no longer valuing the inventory at the lower replacement cost. As a result, we are expecting a limited benefit from LIFO during 2022 versus the more significant tailwind we saw throughout 2021.

As we unwound our historical debit LIFO reserve, our first quarter results were in line with those expectations, and our outlook on this item for the year is unchanged. Our first quarter effective tax rate was 23.9% of pretax income, comprised of a base rate of 24.3%, reduced by a 0.4% benefit for share-based compensation. This compares to the first quarter of 2021 rate of 23.5% of pretax income, which was comprised of a base tax rate of 24.4%, reduced by a 0.9% benefit for share-based compensation. The first quarter of 2022 base rate was in line with our expectations.

For the full year of 2022, we continue to 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 the tolling of certain tax periods. Also, variations in the tax benefit for share-based compensation can create fluctuations in our quarterly tax rate.

Now we'll move on to free cash flow and the components that drove our results. Free cash flow for the first quarter was \$579 million versus \$790 million in the first quarter of 2021, with the decrease driven by a smaller benefit from reduction of debt inventory investment in '22 versus '21, and the differences in accrued compensation. For 2022, our expected free cash flow guidance remains unchanged at a range of \$1.3 billion to \$1.6 billion.

Our AP-to-inventory ratio at the end of the first quarter was 129%, which once again has set an all-time high for our company, and was heavily influenced by the extremely strong sales volumes and inventory turns over the last 12 months. We anticipate our AP-to-inventory ratio to moderate off this historic high as we complete our additional inventory investments. We continue to expect to finish 2022 at a ratio of approximately 120%.

Moving on to debt. We finished the first quarter with an adjusted debt-to-EBITDA ratio of 1.72x as compared to our 2021 ratio at the end of the year of 1.69x. We continue to be below our leverage target of 2.5x, and we will approach that number when appropriate. We continue to execute our share repurchase program. And during the first quarter, we repurchased 1.2 million shares with an average share price of \$664.15 for a total investment of \$775 million. Subsequent to the end of the quarter and through the date of our press release, we repurchased an additional 0.2 million shares at an average share price of \$694.70. 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 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 want to make a few comments on my decision to step down from the CFO position and transition into a different role with O'Reilly. It's been an honor to have been part of this outstanding team for over the past 16 years. Working together, our team has pushed O'Reilly to incredible levels of success, and I'm very grateful that I can continue to be part of our growth moving forward, as I focus more of my time on enhancing our team and the processes we use to provide even better levels of customer service.

I could not be more excited for Jeremy as he transitions into his well-deserved and earned promotion to CFO. Jeremy and I have worked closely together since my first day at O'Reilly, and he has been a trusted adviser ever since. I'm extremely confident in Jeremy's abilities, and I know his transition will be seamless and successful. I want to thank our team for their support over the years, and I'm excited about the opportunities we have in the future.

This concludes our prepared comments. And at this time, I'd like to ask Richard, 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) And our first question on line comes from Greg Melich from Evercore ISI.

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

First, congrats, Jeremy. And Tom, we'll find a way to hunt you down now and then. Thanks for everything. My question, I would say twofold. One, inflation in the first quarter, did you say it was high single digits? And was that number for the whole company or just DIY or Pro?

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

It was high single digits, and that was for the whole company, Greg.

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

Got it. And it sounds like going forward in your guidance, would you assume in that 5% to 7% comp for the year that it would be high single digits, or would it moderate to more like mid-single?

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

We saw inflation pick up significantly in the back half of last year. So as we lap those, we would expect to have less inflation, although we continue to see moderately more. So the answer is, at this point, we would anticipate seeing less inflation in the back half of the year.

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

But in the 5% to 7% comp guide, you're assuming less in the back half, but it might be mid-single digits? Would that be fair?

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

Time will tell what that number is. It will be somewhere, plus or minus, mid-single digits.

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

Got it. And I guess my second question, I'll give someone else a chance, on the SG&A. So with the higher growth in the first quarter, but still 2.5% for the year, how do you manage to do that with headcount up 9% on some wage inflation out there? Like what are the -- what initiatives are there to help moderate the growth in SG&A dollars?

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

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

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

Yes. Really, the way that we're thinking about SG&A, especially from a store and distribution payroll standpoint is, as you've always heard us say, we do everything we can to manage our payroll headcount, everything that goes into our staffing, both in the stores and the DCs, best we can for the short term. But most importantly, we want to do the right things for service levels for the mid and long term.

And really, the first quarter, Greg, was kind of a story starting out, even though it seems like old news. Today, we started out with Omicron and a few things that we were still under some quarantine protocols and things like that within the company. And we had to run probably more hours than we would have wanted to for the sales volumes, but we needed to be there for our customers. We want to always be there every hour they need us.

And so we started out a little bit less desirable in the quarter. But as the quarter went on and volumes ramped, we continue to make sure we are doing the right thing. And really it was more of a story of sales than it was payroll. We felt like we had to make sure we were doing the right thing heading into the busy season, heading into spring. And though we could always adjust a little bit more on the short term, we didn't feel like that was the right thing to do headed into the remainder of 2022 to ensure we're supporting service levels and some of the initiatives you asked about to take share this year.

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

Yes, Greg, and to add to that, as Brad said in his prepared comments, comparing against first quarter last year, we had unusually low SG&A last year, and we're comparing against that -- first half of last year, I'm sorry, specifically first quarter.

And as we compare against that, as we've said last year and Brad and Jeff before him said, that was really a number that we knew needed to increase from a service level standpoint. So we plan for a little higher SG&A in the first quarter, and we fully expect that to come back down in that 2.5 range for the balance of the year.

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

You see Greg, it's a little bit more about if we could have spent more last year, we would have.

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**Operator**

Our next question on line comes from Chris Horvers from JPMorgan.

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

So my first question is on the intra-quarter shocks of the gas price surge and the war, can you talk about how that played out? Did the consumers initially sort of dipped down, but then sort of the trend subsequently rebound after that initial shock? And is that what ultimately allowed you to have that strong 2-year and 3-year trend in March?

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

Yes, Chris, I'll tell you, as we said, the first part of the quarter was really choppy, especially on the DIY side. There was a lot of -- there was more fluctuation in sales volume early in the quarter for the reasons you called out. The resurgence of Omicron, we felt like that impacted us earlier in the quarter.

Fuel impact, probably didn't happen as much until the midpoint of the quarter until the back half of the quarter. But as I said in my prepared comments, we started to see more consistency in our DIY comp as we progressed through the quarter, specifically in the last month of the quarter and leading up to the call today.

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

Got it. And then maybe can you talk more specifically about what you're seeing in April in markets where spring has at least started to break. Are you seeing that 3-year trend that you saw in March hold?

And then on your comment that you're trending below the midpoint of the guide, is that a year-to-date comment? And would you say that you're trending below the low end of the guide as well?

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

Chris, I appreciate the question. April is a short portion -- April to date is a short portion of the second quarter. So probably not appropriate for us to parse that out. Again, refer back to the last 8 weeks have been much more consistent volume.

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**Operator**

Our next question on line comes from Zach Fadem from Wells Fargo.

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**Zachary Robert Fadem** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Congrats to Jeremy and Tom on the new roles. So first question, is there any way to quantify the weather headwind on the quarter for both DIY and do-it-for-me comp? And how do you think about the dynamics between purely lost sales versus sales that could land later once weather begins to cooperate?

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

Yes, Zach, great, great question. I wish I had a crystal ball and really understood exactly what the impact was. I'll tell you there's really 2 facets to weather in the first quarter that we've dealt with, as long as I've been in the industry, and that is: one, winter weather; and two, spring weather.

So when you look at winter weather, specifically in the early part of the quarter, bad winter weather helps us in some markets short term with sales of things like batteries and wipers, and where people have -- their cars won't start because their battery died because of the cold weather. Then there's a lingering effect that based on the winter that we saw this year, we would expect to see some benefit in the second and third quarters. That's typically caused by rusting components under vehicles from salty roads, damage to steering and chassis components because of roads being damaged by the harsh weather. That would come typically later in the year post spring.

The other weather component would be lighter in the quarter, and that's based on the timing of spring weather coming. And that's really what's been choppy this year is spring. It seems like every time you get a nice day, there's -- it gets cold again and starts raining. And a lot of our DIY

customers depend on non-wet dry, warm days on the weekend to do their repairs. And it seems like we've been pressured with a lot of damp weekends in a lot of our markets this year.

So weather has had an impact. Quantifying that as a portion of some of the other headwinds we talked about that we've seen, we really just can't do that.

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**Zachary Robert Fadem** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Got it. I appreciate the color. And then a follow-up with respect to the outlook. Can you help me understand the dynamics around your sales, EBIT and EPS outlooks all staying the same? But since you're now incorporating about \$700 million in incremental buybacks versus last quarter, does this imply that we should think about your sales or margins closer to the low end of the range versus the previously higher end of the range? And are there any particular line items that would be most impacted by this?

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

So when we look at our guidance in our prepared comments, we said currently, we're trending towards the lower end of our range. Gross margin was where we thought it would be, SG&A total spend was where we thought it would be. A little more pressure on the SG&A than the gross margin, which is the change in the EPS where we've brought shares in. And to the extent that there is a benefit to those shares -- well, there is a benefit for those shares for the rest of the year, implied a little bit down on EPS, mostly driven by the SG&A spend from the first quarter.

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**Operator**

(Operator Instructions) Our next question on line comes from Mr. Brian Nagel from Oppenheimer.

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

First of all, Tom and Jeremy, congratulations on your new roles. So my first question, I know it's going to be a bit of a follow-up. But just with respect to gas prices, obviously, now higher gas prices are getting a lot of attention as a potential headwind to consumer spending. I mean historically, gas prices have had impacts upon O'Reilly in the category broadly.

I guess -- so I guess what I'm asking for is just maybe a little more color on what you're seeing. So if I hear the comments you made in the prepared comments in addition to some of the response to the questions for, it seems like there may have been a an initial impact to higher gas prices, but then you've seen that fade.

So I guess -- or just maybe a little more color on what you're seeing in gas prices. And frankly, if you're in -- if you're surprised at all with how the consumer is, this time, reacting to gas prices.

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

Yes, Brian, this is Greg. I'll take that one and then see if Brad or Tom or Brent has anything to add. I don't look at price point specifically to driving consumers' driving habits. Gas prices definitely are going to impact miles driven over time. Unfortunately, miles-driven data, as you guys know, lingers for a couple of months, and we don't have data for the past few weeks.

But what we believe is if gas prices ramp up incrementally over time, especially the DIY consumer who's typically more economically challenged, we'll adapt to that and budget for it. When you see spikes in fuel prices, like we saw late February, early March, often that will have more of an impact on miles driven and impact our business a little differently.

But that's a short-term impact. I mean over time, those customers and consumers will have to budget a different portion of their income for fuel, because they've got to drive to work, they've got to drive their vehicles. One of the things that's a little different this quarter than what we've historically talked about fuel prices is we're in an inflationary environment, and a lot of things are moving from a cost perspective right now. But at the same time, we're all experiencing wage inflation.

So as fuel prices have increased, wages have increased as well. And we're optimistic that, that's offsetting some of the pressure that fuel prices we've got on miles driven. Do you guys have anything to add, Tom or...

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

It's an unusual environment. As Greg said in the past, you can kind of isolate fuel independently. But as we see these costs increases across the economy, it's just one of many. And in addition to rising prices, we see growing employment numbers, which is also a positive for our business.

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

Brian, this is Brad. The only other thing I'd add to that, I think it's well said by Greg and Tom. But as you well know, with our company, either way, it's obviously a concern with the longer-term fuel prices and miles driven. But some of the years we've had that pressure are the years that we all face that, us and our competitors, the small competitors and the large competitors.

And so just operationally, as you know, like we always talk, we don't operationally, our teams aren't out there talking about gas prices or weather and things like that, they're out there trying to figure out how to take market share. And some of the times that we've had some of those headwinds over the years we felt like we took the most share. So that's how we're looking at it.

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

That's all really helpful. I appreciate it. And then my follow-up question, and I think this is a question I've asked a lot in the prior calls, too. But just with regard to inflation and in product price inflation, are you seeing yet any indications of demand destruction as the cost of your products have started to rise, or continue to rise?

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

Yes, Brian, we're watching that really closely. We look at our product in a good, better, best category mix. And we have not seen evidence thus far of any trade down or any significant trade down.

What we have seen is more of a supply chain issue than a pricing issue where some of our customers have been willing to trade from branded to proprietary or proprietary to branded, or up and down the value spectrum as needed when we don't have maybe exactly the brand of oil they want and stock at that time, they'll trade across brands or trade up and down. But from a price inflation standpoint, we've seen no evidence of consumers trading down.

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

Congrats again.

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**Operator**

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

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

Could you talk a little bit more about Mexico now that you're putting a DC in down there, maybe what you see as a potential, eventual store count. And if the profit model down there is meaningfully different than what you see in the U.S?

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

Sure. So we're slow to announce some things, and we wanted to wait until the DC was underway and the contracts were signed and everything before we talked about that publicly, Bret. But we're happy with our progress we're making in Mexico. We're opening stores, albeit at a slow pace.

Our strategy in Mexico is similar to our strategy here in the U.S. We want to make sure we've got the supply chain infrastructure in place before we really ramp up our store growth at a more aggressive pace because we want that customer experience to be what it's going to be long term, and we want that service level from our DC, for our professional customers, to be at the very highest level from day 1.

So we're growing the market incrementally. You won't see the O'Reilly brand down in Mexico right now. You will still see Mayasa, Orma, and that's part of our strategy. We'll transition that over time. But the first step is to get the distribution center open. As Brad said, that will happen in the first half of next year. And then we would plan to ramp up our growth -- our store count growth in Mexico. And as we grow, consider additional distribution centers at that time.

As far as capacity, one of our major competitors has over 600 stores down there. And we feel like there's a pretty big opportunity to grow our store count somewhere in that range in Mexico as well.

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

Okay, great. And then on the pricing actions, it was hard to find a lot of disruption in the first quarter around that strategy. Could you talk about maybe how broadly it's been rolled out, maybe as a percentage of SKUs? Is it all behind the counter? And is it pretty much done? Are there other areas you're going to address pricing? Or is what you announced on the fourth quarter pretty much in place now?

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

Brad, do you want to take that one?

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

Yes. Bret, I'll be glad to talk to that and try to answer your question the best I can. Look, we're a couple of months into this, Bret, as you know. As we said earlier, we did complete what we're going to do in February, and that was completely rolled out to our entire organization.

As you know, on the installer side, the professional side of the business, it's a far majority backroom hard parts to your question. So that would be a yes overall on your question there. What I kind of want to just go back to that we talked about last quarter when we did this, Bret, is this is an absolute long-term play. It's a share gain play. It's something that we tested out extremely thoroughly, really throughout the entire year last year.

We tested our test -- tested our tests, and we used a lot of science, a lot of data. We used isolated markets. We used markets, metro markets, rural markets, and this was all about something that we felt like would absolutely be a share play, and especially a unit growth and gross margin dollar growth strategy over time.

As you well know, Bret, the way that our installers and professional customers, whether it be independent garage or a national or regional account, they make their buying decisions based upon the overall value proposition, and us building our business, especially our professional business,

which is how we founded our company on the professional customer, pricing is on down the list. It's critically important to have the right price, but all that falls behind.

Getting a car off the rack every day for those shops, then buying from somebody they know and trust the overall service and value proposition. And honestly, as an operator, I would just tell you that I feel even better about it as I did 60 days ago. The more we've moved on and seen the confidence in the team and what we're hearing from our existing customers and the future customers, potential customers that we're calling on, they feel really good about everything we're doing.

And lastly, I'd just remind you that what we did with pricing, we're still at a premium like we said earlier. We don't want to be the cheapest. That's not a winning strategy for us. We don't feel that's a winning strategy in the professional business. And so we really didn't expect to see any reaction from our big public competitors nor the independents. So that doesn't surprise us that we're not seeing a lot.

It was very rifle approach. I think Greg said that earlier. It was very targeted to the SKUs we felt like would not only give us a shot at moving more units with the discounted items, but the overall basket and the entire delivery with an entire job.

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

Yes. And Bret, to add one more comment to that, is our pricing team continues to do what they do day in and day out, and that's monitor, make sure we're competitive in all of our markets. And we talk about the price decreases we made on the professional side, but keep in mind that's offset. We're looking for opportunities to increase prices as well as decrease our prices, and our pricing team will continue on that effort.

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**Operator**

Our next question on line comes from Seth Basham from Wedbush Securities.

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**Seth Mckain Basham** - *Wedbush Securities Inc., Research Division - MD of Equity Research*

Congrats Jeremy and Tom on your new roles. My question is around inflation. First, just in terms of LIFO, Tom, you mentioned no major impacts despite higher inflation. Can you walk us through why you're not seeing any significant change to your LIFO forecast despite higher-than-expected inflation?

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

Well, now that we're in a typical LIFO accounting last in, first out. So as we add layers, we're running the cost of goods from the late last purchases through, and we don't have a debit balance to run off anymore.

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**Seth Mckain Basham** - *Wedbush Securities Inc., Research Division - MD of Equity Research*

Got it, okay. And then secondly, as it relates to inflation impact on DIY comps. For the balance of the year, you expect higher inflation to offset lower transactions, such that DIY comp outlook for the second to fourth quarter is unchanged from what you communicated in February?

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

We expect to continue to benefit from average ticket on the DIY side of the business. And based on the incredible growth of DIY traffic over the last 2 years to have some pressure there.

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**Seth Mckain Basham** - *Wedbush Securities Inc., Research Division - MD of Equity Research*

Got it. And you're expecting additional pressure because of the inflation in terms of transaction counts or not necessarily?

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

Our expectations from the beginning of the year and currently, continue to be that we're going to have some pressure on DIY tickets because of the extraordinary growth over the last 2 years.

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**Operator**

Our next question on line comes from Simeon Gutman from Morgan Stanley.

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

Congratulations, Jeremy, Tom. My first question, it's been asked. I'm not sure if this is an area we're going to speak to. Can you -- the markets in which weather has been more favorable, at least in the first quarter, nothing to do with April. Is the business performing the way you'd expect or better? Is there any commentary you can provide there to build the confidence that when the weather normalizes, we'll see the business come back everywhere?

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

Brad, do you want to take that?

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

Simeon, as you know, it's a fine line between the weather that hurts and the weather that helps, especially the long term. We're calling out weather so much because we do feel like it's really impacted our DIY business, so much more than the DIFM business.

When you look at the first quarter of 2022, we did have some markets that are used to the winter weather, so to speak, that when they got it, it was a little bit of difference in between what we are seeing in other markets. But when you look at our plan, by region, by division and the 2-year stack, our performance, you didn't see the big weather swings from region to region.

Really, what we were seeing that kind of washed out by the end of the quarter, Simeon, is -- it wasn't like markets were off due to weather from month-to-month. It was more kind of a day-to-day, week-to-week thing. You would see a market that had unfavorable, kind of lack of that spring weather we talked about over a weekend, and they bounce right back the next weekend and vice versa.

So not a lot of regional differences. A little bit of difference in the first quarter. But again, when you look at the 2-year stack and we look at our plan by region and division, very, very consistent.

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

Okay. That's helpful. And then the follow-up is looking back at the volume that the business has gained over the last 2 years and what's lapping underneath the comparison, there's probably been some discretionary business that happened when people were staying home, and I know there's no crystal ball to measure that.

But it seems like in the conference call script today, you talked about some of these risks a little bit more than maybe even the last quarter. Is that fair? Are you questioning, do we really know what's in there, what's reversion versus weather, gas prices, et cetera? It's really just testing the confidence that the business reaccelerates from here.

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

Yes. Simeon, we remain bullish both on the industry and on our company performance. Our DIFM business has been strong, and we expect it to be strong for the balance of the year. The uncertainty is around the DIY consumer. And we're still very optimistic there, but there's just -- when you look at fuel prices and you look at some of the headwinds that we talked about in our prepared comments, we just wanted to make sure that we acknowledged the risk for the balance of the year.

We're still bullish. We still feel good. There's a lot of positives that will impact our DIY consumer. They're driving their vehicles, more miles, they're keeping them longer. There's a lack of new car inventory. So there's puts and takes in this. But we're not trying to be negative, we're just trying to acknowledge that there are some headwinds potentially.

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**Operator**

Our next question online comes from Scot Ciccarelli from Truist.

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

So did your commercial sales actually accelerate during the quarter as you made your pricing investments because you said it was having the desired effect?

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

What we would say -- last year, there was volatility in the quarterly numbers because of the stimulus. What we would say is versus our expectation the professional business performed better at the end of the quarter versus our expectations in the beginning of the quarter.

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

Roger that. And then just a quick follow-up, just wanted to clarify, did you guys make any price investments in the DIY side? Or was it all concentrated on the Pro side?

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

The DIY side of the business is much easier to monitor pricing in the industry. And we always have and always will continue to make sure we're competitive on that side of our business. So DIY side is ongoing price adjustments, both up and down to ensure our competitiveness. On the DIFM side, it's a little tougher, and we took a more aggressive approach on the DIFM side this year.

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

Okay. So just so everyone is clear, your actual, let's call it, more aggressiveness on the pricing side was really focused on the Pro and the DIY, you're always kind of pricing against the market.



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

That's correct.

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

Yes, that's correct.

**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 & President*

Thank you, Richard. We'd like to conclude our call today by thanking the entire O'Reilly team for your continued hard work in delivering yet another solid quarter. I'd like to thank everyone for joining our call today, and we look forward to reporting our second quarter results in July. Thank you.

**Operator**

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

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