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ORLY.OQ - O'Reilly Automotive Inc Analyst Day

EVENT DATE/TIME: AUGUST 23, 2022 / 1:30PM GMT

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PRESENTATION

Mark Merz - *O'Reilly Automotive, Inc. - Senior VP of Finance*

Welcome to the O'Reilly Analyst Day. My name is Mark Merz. We're -- if everyone could go ahead and find a seat, we're going to go ahead and get kicked off today. First of all, I'd like to welcome everyone. Thank everyone for making the trip. I had a barrage of e-mails last night on all of the delays in flights, especially out of the Northeast, so we really appreciate everyone making the effort to get here. We'd like to welcome everyone who is listening online to the webcast.

So as we get this kicked off today, we're going to start with our forward-looking statements. So I'm just going to read a piece of this. We intend to be covered by and we claim the protection of the safe harbor provisions for forward-looking statements within the meaning of the 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. Forward-looking statements speak only as of the date they were made, and we undertake no obligation to publicly update any forward-looking statements, whether a result of new information, future events or otherwise, except as required by applicable law.

Okay. So today, I'm just going to talk a little bit about what you guys can expect for the day. So as you could see from our schedule, we just had the meet and greet with management. Hopefully, everybody had an opportunity to sit down and talk with our team. We'll have about 2 hours worth of prepared comments, and then a Q&A session.

So I would ask that during the prepared comment portion of it, which will be about an hour, if everyone would please just jot your questions down and hold them. And then we'll have about an hour of Q&A and hopefully get to everybody, a couple of questions from everybody during that period of time.

I did want to mention a couple of other things. I know that we've historically had these events every year. We haven't had one since 2019 because of the pandemic, but we're so glad to be able to do it again. Going forward, we are going to host these events every other year. We still plan to rotate around our distribution centers. But as you know, we don't provide new information at these events.

They're more of just an opportunity for you to come in, be able to meet the management team, see the operation, see where the rubber hits the road in our DCs and our stores. We know it's very difficult for you guys to have to travel and schedule these things. So going forward, we're going to do these events every other year.

Before I go any further, I want to talk about the most important thing there is here at O'Reilly, and that's culture. Here at O'Reilly, everything starts and ends with culture. Our secret sauce is our team and our culture. A lot of you guys that I've talked to on the phone have asked me what separates O'Reilly from everyone else. And I tell you, it's not fancy. It's not a big secret. It's our team and our culture. Before every meeting that we have as an organization, someone is assigned to do culture. And what that means is they have to pick one of our culture values, speak to what that means to them and then speak to how they've seen that culture exhibited within -- in the company. I'm not going to do that specifically today, but I do want to talk about one of our culture values, which is commitment.

The last 2.5 years or so have been absolutely unprecedented, as you all know. O'Reilly was tremendously successful during that period of time. There's a reason for that. It was our team and our culture. Our team's commitment to making sure we were there to take care of our customers to making sure our customers had their vehicles to go to work, to go to the doctor, to go to the grocery store.

The level of commitment exhibited by our team over the last couple of years is unbelievable, and we are so grateful to the efforts that they put in to help us be a successful company. This event today, Charles and his team did a fantastic job setting it up. The commitment that they provided for us today, we thank them so much, Charles. We really appreciate what you did for us today.

As I mentioned, at these events, we don't provide new information. It's more of just peeling the onion back a little bit and talking about our operations and getting to hear from our executive team. There will be a couple of things that Brent will talk about today from distribution operations that peel the onion back a little bit, and I think you'll be excited to hear some of those things. So with that, let me bring up the management team that's present here today.

So our speakers today will be Greg Johnson, our CEO; Brad Beckham, our COO; Jeremy Fletcher, our CFO, and Brent Kirby, our CSCO. We also have multiple other members of our management team here today. Many of them are seated on the back row, and you'll get an opportunity to meet and talk to them today. Eric Bird, our Director of Treasury and Investor Relations is also here today. And then we also have Tom McFall, our previous CFO, who turned the reins over to Jeremy just a couple of months ago. Tom is here today, and he'll be available to answer any questions afterwards, if you would like. I also want to call out a couple of -- Charles.

He is our distribution center manager. He has done a fantastic job getting the DC ready. We've got Ernie, we've got Thad, multiple other individuals. We've got Robert sitting here in the back. We've got Doug Bragg. He's our Executive Vice President of Store Operations, so significant level of experience in the automotive aftermarket here today for everyone to get to meet with.

So with that, I think I'll turn it over to Greg Johnson and let him get the formal part of the day going. So thank you, everyone.

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

Thanks, Mark. Thanks, everyone, again, for being here. We know it's -- it takes an effort and initiative to travel to some of the markets. This is a little easier to get to than Springfield, Missouri, which is why we've try to take this event on the road and get you in some of our newer facilities to see where we're spending capital, how we're deploying capital across the country.

So a little bit about this facility, our 11 in D.C. has been open for about 2.5 years. We used to operate out of a DC that was about 1/2 to 2/3 of this size. And we just -- the market outgrew it. And we needed more distribution capacity, so we built this building, opened it up and, as I said, and I guess, right, during the pandemic in about 2020. So this facility is 408,000 square feet. So it's about average for what we're building, maybe a little bit on the larger side, has the capacity to service between 280 and 300 stores out of this building. So we're going to do a DC tour following Q&A, and you guys will get an opportunity to walk through the facility and see our facility.

For those of you that have seen other distribution facilities, it's similar. Every time we build a DC, we learn something and try to improve upon that with our next DC. As a Mark said, we're going to disclose a little more -- pull the covers back a little bit on DC expansion when Brent speaks here in a few minutes and talk about some of our other exciting DC projects. But wanted to make sure that you guys knew a few things about this facility before I get started.

Today, my slides are slides that many of you have seen before. I'm going to talk about the company performance at a very high level. You guys have read the reports and participated on the call, most of you. And then I'm going to talk about our industry briefly, and then I'm going to turn it over to Brad and then Brent and then Jeremy to wrap up. So clicker. Thank you, Jeremy.

So my first slide, a little bit about the company. We operate 5,873 stores here in the U.S. and 27 stores in Mexico. This is as of the end of the second quarter. We operate 28 distribution centers here in the U.S., plus 6 small DCs in Mexico. I know we've announced a couple of times past couple of quarters our DC expansion in Mexico. Brent will share more about our upcoming DC project there. But to date, we have 6 DCs operating there. We employ a little over 84,000 team members across the country. Trailing 12-month sales were $13.7 billion as of the end of the second quarter. Our market cap as of July 21 was $45 billion. And our DIY-DIFM mix moves around from quarter-to-quarter slightly, but stays pretty much in line. And as of the end of the year 2021, it was 59% DIY, 41% DIFM.

A little bit on our 2022 results. Again, most of you have seen these numbers. Comparable store sales for year-to-date, 4.5%. We talk a lot about 2- and 3-year stacks. I mean, when you think back over what's happened and -- what's happened in retail and our company performance over the past couple of years, I think when you really start comparing us against our peers, you have to look beyond 1 year, especially shift retail DIFM year-over-year.

So when you look at a 2-year stack basis, that comp will be 21%; 3-year, 28.5%. Gross margin year-to-date 51.6%; operating margin, 21.1%. And we've opened 116 net new stores and are on track to meet our projection of 175 to 185 stores for the year. Diluted earnings per share came in at $15.94. We generated $1.2 billion in free cash flow and repurchased $2.2 billion worth of our stock year-to-date under the stock repurchase program.

Full year guidance, I think everyone saw our guidance with our changes with our earnings release last quarter. I'm not going to read all these numbers to you. You've seen the numbers. I do want to comment a little bit on the elephant in the room, which is comparable store sales. We did lower our comparable store sales guidance after the second quarter.

As I said on the call, if we could have looked in a rearview mirror, had a crystal ball and we had known that there was going to be war in Europe, broad-based inflation, high fuel prices and all the things we've experienced year-to-date, we would have had a different outlook from the beginning of the year. But based on performance in the first half of the year, the pressures we faced, we felt it prudent to revise our guidance to 3.5%. And we feel good about that expectation for the back end of the year, allowing us to deliver that result.

I'll talk a little more about the industry in my upcoming slides, but we do remain very bullish and optimistic on our industry. Our industry historically has proven to do well across various economic conditions, including moderate to below-average economy. So we feel good, very bullish, not only about the industry, obviously, but about our company's ability to perform in that environment as well.

Now I shift gears, talk a little bit about the industry. This slide here, 2 charts on here. The green bars are miles driven, and the blue line is average gas prices. As you recall, back during the Great Depression -- or Great Recession back in 2008 to 2012, we had a long-term raised elevated gas prices and miles driven suffered during that time slightly, then grow at the rate that it had grown leading up to that point. There's been some choppiness, but miles driven has continued to grow since then until 2020.

Everybody knows 2020 wasn't a result or have any correlation to fuel prices at that time. It was about stay-at-home orders and the pandemic and people not driving to work and not driving the miles they would normally drive, again, pandemic-related. 2021, miles driven increased. Fuel prices increased slightly. Year-to-date, we've seen spike in fuel prices this year. Luckily, the past few weeks, we've seen fuel prices start to come back down. That's good. And during all of this, we've seen a 2.8% increase year-to-date in miles driven.

So we feel very good about that. The consumer still is healthy, the consumer is still willing to get out and drive their vehicles and miles driven hasn't suffered as a result of the broad-based inflation and higher fuel prices.

More industry drivers. These charts are more specific to the vehicle population itself, the top chart references on the green bars, the vehicle population in millions, the blue chart is light vehicle sales, the SAAR there. So you'll see just an elevation in vehicle sales through 2016. 2017 had a little hiccup. And then the last couple of years, with the chip shortage and supply chain changes, everybody knows that new vehicle sales have softened. They just haven't been as many new vehicles available for purchase. It's driven prices up for used vehicles. But the good news is the vehicle population has continued to grow throughout that. Even though there's fewer new vehicles introduced into the vehicle population, the vehicle population continues to grow. When you align that with the chart below, which shows the age of the light-duty vehicles, you see continued growth through 2022 in the average age.

The average age of light-duty vehicles is over 12 years. When you combine all the data on this chart, it's very good for our industry. Vehicles are better engineered. They're lasting longer. You see a vehicle on the road that's 10 years old, it may be on its second or third owner. The paint still looks good, vehicle still runs good. That's more opportunities for wear and tear breakage, more maintenance cycles all these things are good for our industry.

My last slide is industry landscape. Many of you have seen this slide before. Basically, the top right quadrant of this slide shows the top 10 auto parts companies in the U.S., the chains based on U.S. store count. AutoZone has the highest store count in the U.S., 6,115; followed by O'Reilly Advance. And then it drops off because we're only looking at company-owned locations after the top 3.

The chart to the left shows a couple of things. The green bar shows the total number of parts stores in the U.S., and the bottom light green shows the percentage of ownership of these top 10 chains of those number of stores. So the interesting thing here is, since really 2017 or so, there hasn't been a lot of movement. It stayed pretty close to that 37,000 stores in the U.S.

And historically, that number has grown and escalated the ownership, but it also has flattened out to around 53%. So there hasn't been a lot of consolidation within the industry. And the number of stores, the growth is really, when you look at the top 2 chains, us and zone, we're opening stores to really make up that growth just within the top 2 companies there.

On the bottom half of this slide, we talk about the size of the aftermarket. The aftermarket as a whole is based on the fact book, the ACA Factbook from last year is $329 billion. Now we try to extrapolate out of that what our market capacity is, what our addressable market is. So if you look at that slide, the biggest portion of that is professional sales, auto parts professional sales. And then labor component of professional sales, followed by DIY and tire sales.

When you back out the labor on the DIFM side, glass and body collision, you back out tires and you back out margin associated with additional markup on the professional side of the business, and you end up with our component of professional sales from O'Reilly to that customer in DIY, we feel like that number is somewhere between $130 billion and $140 billion. That would be our addressable market. We see that as a very positive because we see that as a tremendous opportunity for us to continue to get out there and grow our market share.

So with that, I'll turn it over to the guy that's responsible for getting out there and growing our market share. Brad?

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

Okay. Thanks, Greg. Good morning, everybody. It's great to see everybody in person after the last couple of years. I'm excited to have everybody in our Nashville facility and get out and see some stores. Our teams here are very proud of the facility and our store is the same when we get out in the stores. But they take great pride in that, not just because of you, no disrespect, but because of our customers who is our VIP each and every day.

I want to start out, like Mark talked about with our culture. I started with O'Reilly in the summer in 1996 as a 17-year-old kid. And it's the only job I've ever had is here at O'Reilly. So 26 years this year. Started out sweeping floors and just had the opportunity growing up in Oklahoma after we bought Hi/LO to move down to the Texas market and run on store and be a district manager and all these things that I had the great fortune of, with our with our massive growth over the last couple of decades. But everything at O'Reilly, to Mark's point this morning, starts with our culture.

And I know in a lot of companies, I'm sure there's some type culture that's documented, a banner hanging on the wall. But I can tell you, over the last 25, 26 years, the week that I went to work for O'Reilly back in the summer in 1996, our culture wasn't even really defined. It wasn't on a piece of paper. It wasn't on a culture card. It wasn't on the wall. It was all these things behind me here that I felt as a new team member, that we have for everyone of our customers and our team.

When I think about pride, not in a selfish way, but pride in our team, pride in our teamwork, when I think about ownership, passion and intense focus on our fundamentals, Greg and Mark already talked about it a little bit, our business, even though it's not easy, it's really a simple business. It's about giving great customer service, having professional parts people and all these things that so many of you have heard us talk about.

But really, our culture hasn't changed a lot in the last 26 years. A lot's changed, but that hasn't. And I just want to make sure that everybody remembers that when you look through the numbers and you look past even like our industry-leading supply chain and the way we run stores, we absolutely work in a people business that the O'Reilly family really founded those foundational things that we ended up documenting is our culture that, again, to Mark's point, we live each and every day.

At the heart of our culture is promote from within. Somebody like me that didn't even go to college has been very fortunate to grow up with a company that promoted virtually 100% from within, especially in store operations. I had the fortune to grow up in our stores and run districts and regions. And we're extremely proud that really, over the last several decades, we've never had to hire outside the company for our field leadership. Our EVP of stores and professional sales that's in the back room, Doug Bragg. He's on his 31st year at O'Reilly. Started out in the distribution center loading trucks, and then working in stores and selling parts and managing stores and similar story to mine, even before me.

And then our -- we roughly have the U.S. broke up into thirds. We have 3 SVPs of store operations and sales, Robert Dumas that oversees the eastern part of the country is here with us. And between those 4 top leaders in store operations, they average, I think, 22 years, not only in the industry but here at O'Reilly or in a company that we acquired. So that's incredibly important to us when it comes to really understanding what our installers, what our professional shops are going through every day.

This isn't a business that somebody can just walk into in retail's retail or business is business. It's really you have to have a good understanding of what make those shops tick, what really happens on the counter every day. Our business is a consulted visit. When you see our stores, we have several thousand SKUs that are out on the front floor. But the far majority of the parts are in the back room, so to speak, behind that counter. And so even when you move on to the next level leadership here, we have 13 divisions in the United States, and every 1 of those division vice presidents ran an O'Reilly store.

They started out in the stores every single 1 of them. They ran a store. They ran a successful district. They ran a successful region. And now they're leading groups of 500, 600, 700 stores for the company. And so we're just extremely proud of our promote from within philosophy that we've been able to hold on to. And we feel like that's somewhat intangible but something that we really want to remind you, such an important part of what we do here at O'Reilly.

Okay. Moving on past culture and people. The next thing we feel like has kind of been our secret sauce over the decades is our dual market strategy. I want to remind everybody that really before myself and all of us in the room in the '50s, '60s and '70s, the O'Reilly family founded the company on a distribution business, delivering and fulfilling for independent parts stores, independent partners. And then over the kind of the '60s and '70s, grew in the professional installer. And it wasn't until the mid-'80s that the O'Reilly -- that our company started really in the DIY business.

And the decision back then was we have this great professional business, we have these independent partners, we have our business that we service the installers, we have this great supply chain. We have the right parts, right place, right time. We have professional parts people. Why not open the doors and extend ours and service the retail business. Back then before that, if a retail customer wanted to buy a part from O'Reilly, they had to go to an installer and have that installed on their car to buy from O'Reilly, so to speak.

And so just to remind everybody, we came from the professional business. And over time, we've evolved into this 50-50 dual market strategy. We're a little bit heavy retail, to Greg's point, especially after we acquired CSK on the West Coast. We didn't lose any wholesale business or professional. We just had the opportunity to have all the retail business that CSK did on the West Coast and up in the Great Lakes area.

So dual market strategy. We see a lot of opportunities. I get asked very often even before this meeting, where do you see the opportunity. We see the opportunity in both. When you look at the addressable market that Greg talked to us about earlier, it's incredible. While we feel, and I know most of you know, the professional business most likely over the next decade is probably going to grow on the macro at a faster rate than the retail business. We have great retail competitors that do a lot of revenue.

And so we still see a lot of opportunity with our big national competitors as well as independents to consolidate the market. So even though the professional business may be growing faster on the whole, we see a tremendous opportunity over this next decade to continue to learn to be a better and better DIY supplier, retail supplier. So we continue to be very excited about both sides of our business.

To talk about DIY a little bit, Ted Wise, that was our Chief Operating Officer for a long time that was a 45-year veteran, started as a driver, ended up our Chief Operating Officer that a lot of you knew. I remember growing up in our stores and moving to expansion markets. And one of Ted's favorite thing to remind us as operators was always we were pushing for the best location. And obviously, location is incredibly important to the DIY customer. But Ted always reminded us that you can have an outstanding location in our business and have an average store. But reverse of that, you can have an average location and have an outstanding store.

So what I mean by that is, is our business is about -- it's about people. It's about that excellent customer service and that top-notch customer service that we always talk about. It's about going the extra mile. These sayings down at the bottom of this slide are actually what we call Charlie-isms.

Charlie O'Reilly was -- he was relentless with all of us that grew up in the business about being professional parts people, always being the most professional friendliest parts store in town. And backing that up with never say no and rolling out the red carpet for our customers and all these things that may seem intangible, but they're so important not only to the professional side, but to the DIY business. Again, keep in mind that when you go out in the stores, we want you to look around the back room, there's 25%, 30% of our SKUs in the front room where a customer walk in and pick up an air freshener or a bottle of wax or an oil change. But the far majority of the SKUs in our stores are in the back part of the house, so to speak, behind that counter. It's not like walking in a full retail company. It's -- you're walking into a store that our DIY customers, they need help, they need advice. They don't know always exactly what they need to diagnose their car. So it's a consulted visit.

And so that's why we stress that the immediacy of need that Brent will talk about here in a second and having those professional parts people -- obviously, location is critical, but the most important thing is these people that are in these pictures here having the right team members that are in the local market that know the community, they live in the community, they match the market, they know the customers. and they're going the extra mile every day to take care of those customers on the DIY side of the business.

To talk about professional in just a minute, every one of you here, just wear out that this business is about relationships. It's about service. Brent is the one -- I don't have here to not steal brent's thunder is that availability, that immediacy of need, all those 1 million SKUs that we have deployed throughout the country, those 28 distribution centers, all these hub stores in our 5,900 locations. With all the history we have over the last couple of decades, building that sales history for all those SKUs that are behind that counter, the professional customer -- they -- if you go out and talk to them, they buy from people that they know and trust. It's not transactional.

They're the best installers in the market, the shop that one of you would take your car to. Time is money. It's not about where you can get the cheapest installation. It's where you know you can get in and out. It's a quality job. You're going to have a warranty when your car rolls off out of the bay. It's all about that immediacy of need and it's about this relationship.

This first picture here is one of our territory sales managers working with one of our shops. We also have here in the middle, as you see out in our stores, we've spent a lot of -- we've made a big investment into technology. Our ability to get that part from the time that ticket prints in the store, sometimes it's our team members printing that ticket. A lot of times these days, it's the shop that's buying through our B2B platform kicking out of pick ticket in the store and our professional parts people pull in that part and getting it out of the stores as quick as possible and getting that part delivered in obviously a safe manner but an efficient manner to get that car off the rack for that installer.

Our professional shops, again, time is money. They're employing technicians that are turning the wrenches right out of school. And these guys and gals that are turning wrenches, they get incentivized by how many jobs they do as quick as possible.

They get paid what we call flag time. And so if a shop is waiting on a part for a day or 2, ordering it from somewhere that it can't get there in 15, 20, 30 minutes, their shop is really not going to be here in 5 or 10 years because their good technicians are going to roll their toolbox down the street or to an OE dealer or to another installer because they can't make a living. And so our TSMs, our territory sales managers, they're out there always not just hard selling, but they're out there really consulting with that shop to make sure they're focused on technology, they're focused on service and they're able to retain great technicians.

And kind of to wrap up here on Professional, beyond the service and the people, we feel like we have world-class programs for these professional customers. They're not just looking again for a transactional partner, they're looking for somebody that's making investments for them and training in technology platforms. We have -- we get a lot of questions about digital business and B2C business, but sometimes we don't talk enough or we don't get asked enough, frankly, about our B2B business. We have built an incredible B2B business over the decades.

When I started in 1996, one of the first people I met out of the corporate office was coming to my hometown in Oklahoma from Springfield to install an old green screen dummy terminal in a shop. That was 1996, and we were connected to our installers back in the mid and late '90s. So we built a really great B2B business. It's very sticky. It's very efficient for not only us, but the productivity of the shop and we're very proud of that.

Same thing with our training. This training you see here in the bottom right is not our team member training. This is our professional installers that we bring into the very room you sit in today. We bring in our technicians from our shops, and we bring in professionals that we're not selling them a product. We're keeping them up on the latest technology. It could be everything from basic drivability things that we're helping our shops train them up from our suppliers that give us help and support from a training aspect.

We may be talking about regular undercar, underhood, brakes. We may be talking about newer technology. We have classes on ADAS. That's one of the new technologies. It's a huge opportunity for us. We train on that. So we're bringing our installers in and they see a premium to partnering with O'Reilly because of that world-class training we have and what we call real-world training. So that's a huge part of the partnership.

And then on the bottom left is just a reminder that our -- basically, our program for our installers or our professional customers is called certified auto repair. What that would be is our program for an independent shop that may not be a big national or regional account or an OE supplier that has a lot of resources.

This is how we partner with our shops and we help them fund things that they need to do for their shop, if they need a new sign, if they need to improve their parking lot, if they need to improve their lobby or their customer experience. That's how we partner with them to make sure that they have a nationwide warranty to compete against a regional or national type account. And so we really feel like we -- those are just the highlights of many programs we have to partner with our installers.

Just real quick, -- what did I do? Okay. I can wing it while they're bringing it up. Move on real quick, just give an update on our store growth. They just have you look at your deck. I think I hit something. Thank you. Nice job. So no big surprises here. We feel like we're projected to land kind of in the midpoint of our guidance of 175 to 185 net new stores in 2022. We're on track there.

Just a little bit of history in the bottom left about our historic acquisitions. A couple of years after I started, we acquired Hi/LO. At that time, we had 200 stores, Hi/LO had roughly 200. We doubled the size of our company, and that was pretty historic on Hi/LO. Mid-State, that was based out of here in Nashville and all the ones in between that you well know about as well as Mayasa down in Mexico, you know really where we're growing And most all of you know, kind of where we still have a gap in footprint kind of between Washington, D.C. and New York City.

I want to give a quick update. We're very excited about the Mayasa team that we have operating now down in Mexico. We're a couple of years into the acquisition of Mayasa. All of us have spent quite a bit of time down there, a little bit less during COVID. But just want to highlight that we have an incredible, incredible leadership team down in Guadalajara. It was a family-ran business that we knew from the industry for a long time.

They were a very respected family that ran just an incredible wholesale business out of Guadalajara and had the other 5 distribution centers, really small distribution centers in other regions in Mexico, but their main facility is in Guadalajara.

Brent is going to give an update on distribution. so I won't talk about that, but really just want to highlight that we still got a lot of work to do in Mexico. We're still very small. Our business today down there is more of the jobber business.

If you think about the United States, maybe 20, 30 years ago in terms of -- we think it's fragmented now. Again, when O'Reilly went into the retail business, you think about all the independents that were in the U.S. versus the consolidation that's happened over the last 20, 30 years. You kind of go back to those times in the Mexican market. So we have a big wholesale business, a big independent business, a big installer business. And really, we're just getting started from a DIY retail standpoint.

If you can see the pictures on the left, the prototype store in the top left and the front floor on the bottom left. For those of you that have seen our stores, that may look familiar to you. That's one of our new prototype facilities. Orma was the Mayasa team's retail store locations. And so we partnered with them. They had very small showrooms in their store. They were, again, majority wholesale. So we partnered with them.

Our team in the U.S. is kind of teaching their team how to fish when it comes to DIY, building planograms, all those type things. And so we already have a couple of prototypes that is going to be an easy sign change down the road when we feel like that's the right thing to do. Just keep in mind that we're new to the market. They know the markets. They know the culture. and so we're learning as much or more from them as they're learning from us. Over time, we'll figure out what the exact right strategy and the timing of branding. And again, Brent will talk a little bit more about that here in a second.

So I'm going to wrap up and hand it over to Brent. We always start with culture, to Mark's point. And a lot of times we end with humbly saying that our mission statement internally has always been we'll be the dominant auto parts supplier in all our markets. And that's what we focus on every day is taking care of our customers about anybody else. So with that, I will turn it over to Brent.

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

Thanks, Brad. Good morning. Thank you guys for making the trip to Nashville today. We appreciate you spending some time with us. Good to be back in person for these kind of things. I'm going to talk a little bit about best-in-class inventory availability and how we do that with the consciousness to controlling our dollars in inventory and talk a little bit about life cycle product One of the things that's extremely important in our business is early late model coverage, having that faster than the competition, being out there. Our merchandising team and our inventory control team do a great job of looking at vehicles and operation data, looking at as parts are coming into the marketplace and into the part cycle, looking at that data. We look at it regionally. We have inventory control analysts that look at different regions of the country. So we look at those demand triggers, and then we start integrating those parts into our DCs. And we'll talk a little bit about our distribution network here in just a moment.

And that gives us the ability to see those parts and pull those parts where there's demand across the store base. As those parts get more into the mainstream of the demand cycle, we develop good, better, best offerings. Our teams are constantly, every year we look, we work with Brad and the operations team, to look at how do we push parts that are needed into our stores into the 4 walls of our stores. We continually focus on getting those parts as close to the customer as we can as they hit the peak of that demand curve.

At the same time, we're also looking at parts as their demand curve is waning, and we start pulling those back. And we utilize our supply chain and our network of distribution nodes to pull those parts back first to hub stores, and then up into DCs. And then ultimately into our national DC as those parts are at the end of their life cycle.

So this is something that's constantly going on within our merchandising team, our inventory control team. We work very closely with Brad and the operations team. A store manager can call and request parts. If they're getting asked for parts, we also look at demand signals that are coming from those stores for those parts to make sure that we get the parts best placed within our supply chain to meet that demand while keeping an eye on our inventory investment.

Talking a little bit further about that network. What does that network look like? We have an industry-leading, best-in-class supply chain. We have the ability to deliver parts more quickly than many of our competitors, and we focus on that every day because speed is really important. When you've got a car that's on a rack, you need a part, it's how quick can I get that part and that's who gets the sale. So we recognize that. And we've continued to invest in our distribution infrastructure.

Greg mentioned it earlier, we've got 28 distribution centers domestically in the U.S. They're located in the populous centers of the country. We have multiple runs that go from those DCs to those stores multiple times a day. Plus we replenish our stores 5 days a week. So not many companies have that frequency of replenishment, but we do. Our industry demands it, and we have the capability to do that.

We also have a network of hub stores, and we have those hub stores segregated. They have anywhere from 30,000 SKUs up to 95,000 SKUs. So again, depending on the market density and the market demand, that allows us to place pools of inventory closer than even our DCs can place them within the local markets.

And those individual hub stores make runs to the service -- the stores that they service, their spoke stores throughout the day. So we can literally -- you can walk into a store today and say, I need an alternator for a 1997 Ford Taurus. Our parts professional can look and say, I don't have it, but I can have it by 3:00 this afternoon. So that's how important that is to be able to get that sale.

We continue to invest in this network to grow it, to continue to be able to scale these capabilities to serve customers across the distribution nodes.

We've referenced this a few times. We're going to kind of peel the onion back a little bit and give you a preview to the further investments that we're making in our industry-leading supply chain with our next 3 distribution centers. We're excited about a distribution center that we're going to be opening on the island of Puerto Rico.

That's going to begin servicing stores there as we begin to expand on the island in early 2023. That can service up to 50 stores. Tremendous market down there on the island. We're not there yet, but we're excited to be going.

Our next distribution project, Brad mentioned this as well, is in Mexico. This facility is currently under construction. It's over 300,000 square feet, and we're very excited to get it open in the late first half of 2023 as we continue to scale and bring our distribution and parts availability model to our expansion in Mayasa. So pretty exciting.

And then the last project on here is a relocation of a legacy DC at our home base in Springfield that's actually grown across many buildings. As you can imagine over time, moving that into a new building and giving us some additional capacity there, especially for direct imports and processing those as well as replenishment for the stores in that area. So we continue to invest to grow our distribution and supply chain capabilities, and these are the next projects that we're very excited to share with you today.

We also go to market. Product is extremely important in our business, and quality of product is extremely important in our business. Obviously, when a customer makes an investment in a part, they need the part to work. They needed to get their car back on the road, and they need it to last. So we historically have gone to market very strategically with a blend of proprietary brands as well as well-known national brands. And we continue to go to market that way.

We have, over the course of time, our proprietary brands continue to grow. And our merchandising team, our sourcing team does a tremendous job of quality, along with feedback from Brad and the operations team. We've been able to grow many of these national brands to scale that we didn't even think was possible, to be honest with you. So today, over 50% of our revenue is made up of our national brands -- our proprietary brands, rather.

And when you go behind the counter to hard parts, that percentage is actually even higher. So we continue to see our professional customers and our retail customers gain affinity for these brands, and we continue to grow those.

We also maintain and recognize that there are many national brands that still have tremendous affinity with customers, especially in AG and Heavy Duty and different specialty segments within the automotive aftermarket. So we continue to maintain great relationships with these leading companies and continue to sell their brands as well.

Focusing on the customer, you heard Brad talk a lot about our continued focus on both the DIY and the professional customer. And you heard Greg talk about the market opportunity that we have out there today. And we've continued to really focus on being there and being available to our customers whenever, wherever they choose to connect with us, whether they visit a store, whether they call or whether they click one of our websites.

And we certainly saw the investments we've made in our retail website continue to pay off coming out of the pandemic. We saw customers going there more than ever before for information on parts, support and using our curbside pickup, which we launched during the pandemic as well, just for convenience, and again, immediacy of need and delivery of those parts. We continue to invest there.

Brad mentioned our B2B capability with our field professional sales team as well as our firstcallonline.com, our B2B website, which continues to be a preferred method for many of our shops to do business with us because, again, it takes friction out, it builds speed. It allows them to get the cars out the rack more quickly and make more money in the course of a day.

We've continued to invest through the pandemic and through the last several years. I know the last time we talked to you guys, it was 2 years ago, we're talking about some of the investments and changes we were making to improve the content on our website to improve our search capabilities. Those efforts have continued in earnest.

We have teams of folks that work on product descriptions, product spec information, how it searches through the search engines. We've developed video content, how-to content, 360 spin images. We do a lot here to improve, being the first to come up on an organic search when a customer looks for auto parts near me or when they tap in a specific auto part.

The other thing that we've done is speed again is critical. When you look at our retail website, as sales have continued to grow, 75% of those sales are picked up in a store. So again, it speaks to the fact that the customer can't wait on that part. They got to get their car back on the road. So our supply chain and our ability to give them a time-definite promise of when that part will be at that store for them to pick up is critical.

And we've worked on our back-end distribution logic on the website. So it looks across multiple DCs now to deliver the best time-definite promise for that part when a customer is looking for that part and ready to make a purchase.

Ship to Store is another thing. We've talked about the capability within our supply chain, the pools of inventory within our distribution centers and our hub stores. The other thing that customers are really looking for is I need the part. And before we made these changes, a customer could only see the parts in that store.

So you had to zip into a store, you had to shop a local store. You can see the parts selection in that store. We've changed that so that customers can now look and they can see not only what's in the store, but they can see what can be shipped to the store and by what time and what day. So that unlocks the capability of our supply chain upstream.

And we've seen tremendous adoption of that. 50% of our revenue through the retail website is actually coming from something that was shipped to the store to meet that time-definite promise. So we're having great success there. We're going to continue to expand that logic to our B2B website as we move forward today, many times it's a phone call, working with our professional team in the back of the store to get that time-definite promise. We're going to be able to syndicate that across our B2B website, and we think that's going to be very powerful for our professional customers as well.

The other thing that we take very seriously is voice of customer. We have a voice of customer framework that we have stood up to capture survey data from customers, retail and professional across all of our websites, folks that visit our stores, our loyalty customers. And we continually prioritize our user experience enhancements based on their feedback to continue to take friction out of the shopping experience.

We've talked a lot about images, 360 spin images and ability to zoom on images When you think about shopping and auto part online, does the bulk pattern match up. Does the pulley look like the one I'm trying to replace. Those become very real questions when you're trying to replace that part and trying to find out where you can get at the quickest. And this is something we've grown tremendously in terms of the quality of our content. Over the last several years, we're continuing to invest in this. We have over 125,000 360-degree spin images where you can spin the image on the website, you can zoom on it. You can actually look at the details on the website. So this is a work that continues and we're excited about how the customers are receiving it.

The other thing that we do is -- and we recognize the importance, just like when you walk in our store, it's very important that we've got a professional parts person behind the counter. Somebody that really knows parts, knows how to help me get what I need and give me the confidence when I walk out of there and make that purchase that it's going to work on my vehicle.

The other thing when you're shopping online, you need support sometimes with chat, and we do live chat with customers. We have parts professionals that chat through the website that answer questions and follow up with customers to try to give them the assurance that they're getting the part that they need. We've taken that chat platform.

We'll continue to expand it. We're actually using it internally for our store team members to be able to contact our customer support team. Before that was a phone call. Now they can do it through our chat platform. And we're seeing good receipts there.

We also have a technical support team that actually really knows parts, deep knowledge of parts. And if a store needs help with that, they can now chat with that tech team as well versus having to call and wait. So we're going to continue to add speed and credibility to how we support customers whenever and wherever they choose to engage with our brand.

Loyalty customers, we have a growing and a vibrant loyalty base, and we've continued to see this base grow and become more active over the last several years. We continue to work on how do we interact with these customers. And our program is very simple, there's not a lot of gimmicks with it. You spend $1, you get a point. You get 150 points, you get a $5 award. And we were sending those rewards via e-mail or snail mail, which we got feedback from customers, snail mail was too slow.

They didn't get their points fast enough. You know what, we got rid of it. We enable text. So now we do text and e-mail -- we launched that earlier this year. We've gone to fully electronic delivery, and we're very excited about that. We've got great feedback from our retail customers on that change. So we continue to use this program to actively engage our most loyal customers and to continue to be their first choice for the parts they need for their vehicles.

And with that, I will turn it over to Mr. Fletcher.

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

All right. Thanks, Brent. I just want to maybe start off by adding to what the rest of the team has said this morning to thank you all for making the trip back here to our distribution facility. It's great to see everybody in person again. I'm going to spend a few moments and discuss some financial highlights of the company, but we are coming up on that hour time frame and want to be sure that we leave time for Q&A. So we'll be a little bit brief in my comments. And that's by design.

The goal of our time today is providing an opportunity for all of you to hear from Brad and Brent and Greg about the core fundamentals of our business. But a few things that I would highlight for you as we just think about just the financial performance of the company. The other thing I'd tell you is that everything that you're going to see here today, you can pull this financial data for yourself. There's nothing really new or fresh on my slides.

But I think in particular, as we look at just a longer-term view of our store revenue growth, one of the keys, I think, one of the key advantages that we provide 1 of the important characteristics of our company is the consistency by which we've grown the company over several years. So for sure, you see a level step change in the pandemic. We saw our business come on and surge.

But I think what this slide reflects both in store growth and in sales, but then also with the next slide, looks like when we talk about comparable store sales performance is, we've been able to perform consistently financially, grow and continue to provide a high level of returns for our customers because of all the things that the guys have talked about already today: our focus on customer service, our commitment to executing our dual market strategy this the competitive advantages we gained in availability and distribution. And that's really what drives what you see here.

For sure, comparable store sales, it's been an exciting few years for us. And I think as much as anything, been very, very pleased with what we've seen in 2022. Even though we had to reevaluate our guidance, it's a challenging process to come into this year to set where we would be there, still feel very favorably about where we're at to be able to comp on top of the comp on top of the comp and to drive year-to-date comparable store sales at a 3-year stack, up over 28%.

Moving on to operating profit dollar growth. This is really kind of the lifeblood of how we think about our business financially. Our goal is to drive growth in operating profit dollars. Lots of different factors drive into that, but a significant level step change up in that as we've seen through the pandemic and have been able to sustain that level of profitability as we have thought about an enhanced level of productivity in our stores, being able to produce more per unit against the fixed cost that the teams have managed very, very effectively has driven us to a level step change in our profitability and the economics of our business. And that's been a very positive step and something that we all feel very good about in the sense that we've been able to sustain it.

Obviously, that translates into EPS. We kind of get caught up in the individual years and thinking about what the next quarter and the next year is going to look like. So it's always good to step back and look and see that over the course of the last 10 years, we've grown EPS at a compounded rate of 23% per year.

And as much as -- as we've seen that accelerate during the course of the pandemic and the volume that we've seen, this is really a reflection of how we execute our business model, of how we approach our markets and all the things that you've talked about we've talked about today from a core fundamentals perspective, but it's always nice to see the pretty line going up at that level of pace for sure.

Moving on, maybe spend a little bit more time here on just our free cash flow performance. Obviously, all of what I've talked about so far translates into strong free cash flow generation. We've seen that continue to accelerate good productivity out of our deployed assets, continue to see net inventory investment drive. You see little bit less CapEx over the course of the last couple of years, as we've talked about a heightened plan this year and still feel very positive about our ability to deploy capital within our business. And really, that transitions us into the next slide and how we think about use of capital.

So for those of you that have been familiar with our company for a long period of time, there's nothing new and unique about the bullets at the top of this slide. Certainly, this has been a more heightened year for share repurchase, but our focus really hasn't changed. We still see our ability to grow and invest within our existing company by deploying capital along these priorities continues to be where we think we provide the best value to our shareholders.

So we're always going to invest in our existing store base. We've talked about initiatives today, making sure we've got that inventory availability advantage. We think we continue to have great opportunity to grow within the United States and within Mexico from a greenfield perspective. And we continue to be an opportunistic acquirer to consolidate the industry. Those deals, the big deals maybe aren't as prevalent as they were in the past, but we continue to -- where we see opportunities to really acquire talent and insight and experience within markets that continues to be a great use of our capital. To the extent that we generate more cash than we deploy back into that, right? We're a broker record. We want to be able to return that capital to shareholders. And you see a little bit of a snapshot in time here on the graph, the cumulative repurchases since 2014. Really, since the beginning of our buyback program in January of 2011, we've returned over $20 billion of capital to our shareholders in the share repurchase program.

For sure, our focus when we think about capital structure, still heavily committed to investment grade. We've talked about our leverage targets there. They've been pretty consistent over the course of time. We think our business operates best at those levels, and we'll continue to work back to those. But then really, as we think about our share repurchase program, our focus has been really to be consistent, to always be largely in the market buying back when we can to have the success of our business reflected in our ability to continue to deploy capital in that way and then to be on top of that opportunistic when we think the conditions would support that. So that's really what you see in this slide. And again, the results look a little bit different quarter-to-quarter, but the strategy, I think, largely has stayed the same.

Okay. Well, I guess, with that in mind, we've run up right -- look at that, like right on the hour. Mark is going to be so proud of us. We're right there. So we can start maybe the Q&A. I'll turn it back over to Mark.

Mark Merz - *O'Reilly Automotive, Inc. - Senior VP of Finance*

Okay. Thanks, guys. That was a fantastic presentation. Just a couple of quick little housekeeping things. The bathroom is out the door to the right, if anyone needs to use the facility, so please help yourself. there's plenty of food and beverages back behind there, so please feel free to get up and grab something to eat or drink if you need to.

One little item I did want to mention, and I know you're going to be very disappointed in this, I'm not going to be able to join our second store tour today. That's not the disappointing piece. Greg is also not going to be able to join our second store tour today. As you can imagine, risk is something that we at O'Reilly, take very seriously. So we all can't travel together at the same time.

So Greg and I will be on an earlier leg that is leaving Nashville today. So we will certainly be here for the lunch. We'll be here for the distribution tour. We'll be here for our first store tour, but we'll have to jump out before the second tour. Now Jeremy and Brent and Brad and the rest of the team will still be here for the second store.

So we're going to go ahead and jump into the Q&A section. So how we're going to do this? Eric is going to start on this side of the room. I'll start on the other side of the room. We're just going to go back and forth. Just please raise your hand, we'll hand you the mic. Please speak into the mic so those that are listening on the webcast will be able to hear the question. And then one of our team up in the front, we'll do it. Now I've got to go back and give the first question to Simeon here. I think he's going to fall out of his chair if I don't do that.

QUESTIONS AND ANSWERS

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

Hopefully, you can hear me on the webcast. Thanks for the question, Mark. First question is in terms of the inflation that the business is experiencing, I guess, the ticket growth. How much of it do you think is structural tied to labor, supply chain versus how much is tied to commodity prices? And should I ask my second question now?

The follow-up is looking at this chart of EBIT growth, it's been pretty astounding. I think this year, if we filled in the green line, it would be flattish. The question is, does the same level of comp going forward produce? Will it produce the same level of incremental margin going forward? Or does the business just go through some type of EBIT digestion period?

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

Jeremy, do you want to take a shot at that?

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

I can maybe answer the second question first. It's kind of hard to know today what where we'll settle that in terms of what the broader inflationary environment is going to be. I don't know that there's anything fundamental in our business that's changed as we sit here today versus how we would have thought about incremental changes in how we leverage our expenses on a go-forward basis. But obviously, still -- so lots of things changing within the cost environment. We're cognizant of what could change there.

But our expectation is that we've got a lot of pricing power in our business to the extent we see pressures, we can price them through. And sometimes that affects what you see in the gross numbers, but which makes it hard to say, hey, this is the comp that you lever at or something along those lines. But I think fundamentally, where we're at today, we think is a sustainable level of productivity off of our existing assets in the store sales that we see.

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

I may jump in there real quick, Simeon, on the second one. when you think about our margins and you talk to Brent and I and the teams in the back about just staffing and everything that's happened in the last couple of years, we found a lot of productivity. We had to figure out where there were some efficiencies. There are such customer demand and a little bit more turnover than we would like. So we found some productivity in some areas. Some tech investments, some just on the street, figuring out how to do more with less.

But at the same time, when you look at the comparison to last year, there's many areas of distribution and store ops that we were running even more lean than we should. From a customer service standpoint in a just DC to store, store to customer. And so it's a little bit of both, while we found a lot of productivity. And we do have a little bit more turnover right now, nothing material, but in our DCs and stores we're just going to continue to manage the business for the mid and long term. We're not going to -- that there's things we could take out for the short term, but it wouldn't be the right thing to do from a customer service and a long-term perspective.

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

And Simeon, on your first question on inflation and input, we're not going to obviously going to break out how much of that is each of those buckets. You hit on the buckets. Labor impacts both us and our suppliers. So that's an input cost, both to SG&A and to cost of goods from our suppliers. As far as elasticity and commodities, there's not that many categories that we see as being truly elastic in our industry.

We're in a nondiscretionary category out there where people don't come in. It's not a want-based purchase. It's a needs-based purchase in our environment. So when you talk about elasticity and commodities, we think about oil, base oil prices going up and down. And our prices and competitive prices always fluctuate up and down quarter-to-quarter based on index, the same thing with lead float in batteries. You're going to see that in an inflationary environment or a normal environment. You're going to see those commodity prices move up and down. The one thing that's a little different in the environment we're in today from a commodity standpoint as some of the packaging.

We've seen some input cost with containers, both aluminum and plastics for some of our products that have driven some price increases up. As always, our merchandise team pushes back on everything and we negotiate price increases. But our expectation is when things normalize, we're going to try to keep most of that margin. We're not going to go start reducing prices some of that, that's coming down.

And we're very rational in our industry with pricing, and I assume that will be consistent going forward and barring someone in our industry doing something crazy with pricing. We would remain very rationale we have and try to maintain the price points that we've built.

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

It's Michael Lasser from UBS. You mentioned the goal is to generate incremental gross operating profit dollars over the last several decades. The auto part retail industry has become significantly more consolidated today than it was a ways back. And at the same time, the competitive intensity is rising, as evidenced by some of the price investments that O'Reilly has made some of the price investments that AutoZone has made.

Now the industry is left with a lot of really big, really strong competitors, does all of that mean that on the same level of sales, it's just going to be more difficult, more expensive to drive the same level of operating profit dollar growth.

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Yes, I don't think that that's the conclusion we would come to, Michael. We still think that the industry presents a lot of opportunities for us. We saw it in some of the slides, there's a lot of fragmentation. We think that there's -- there are places where we can still execute, enhance how we go to market with all the types of things that we've talked about today and continue to gain share. We think that what we've seen as a level step change up in just how to think about operating profit in our business as we've gained more share during the paying them.

We see that as sustainable, and we continue to believe we've got opportunities. I think it's probably a misnomer to say that as the business is consolidated, it's just automatically become more competitive. When the top 10 change had 40% versus the 53% that they have today, it was still a pretty competitive business. This is a grinded out type of industry that we're in.

So it's both been, I think, something that over the course of the time, you have to work really hard to get at, but still feel like we have the same competitive advantages in how we go to market in our business model and in our culture and our people to be able to drive good results and gain share.

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

It's all about execution. I mean, when you get to the really the nuts and bolts of it, it's about execution. If you remember my slide, in the addressable market that is still out there for us, we represent 10%, 11% market share today. And when Brad and I talked to our teams at leadership conference coming up in January, we're going to talk about that. We're going to talk about opportunity. We're not going to talk about the market share we have. We're going to talk about the market share we don't have.

And we're going to do what we always do. Our team is very competitive. They're out there want to take market share every day, and we're going to continue to give them the tools they need to do so. And motivate them to do so. I remember, I've told the story many times. I don't know if I've told you guys, but Keith Childers, who was Brad's counterpart when he was SVP, got up on the stage and Brad talked about our mission statement, being the dominant auto part supplier in all of our market. And Keith gets up there and Keith's got a heck of a presence when you see Keith up there on stage. He's a big guy, and he's walking around, and he's preaching to the team and said, what does it mean to be the dominant auto parts supplier in all of our markets. Does it mean 51% of the business?

No. It means if there's a car in one of our competitor's store, there's an opportunity for us to take market share. And that's the message we continue to drive to our teams every day. It's all about execution, providing a higher level of service than our competitors in doing what we've done successfully since 1957.

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

My follow-up question is what are the 3 biggest opportunities to improve gross margin from here, especially now that proprietary brands make up more than 50% of the sales. It does as part of that, it seems like more of the CapEx dollars for the distribution network are going to retrofit and resize some of the existing DCs. So how does that play into the gross margin as well?

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

I'll start that off and then I'll let Jeremy jump in there. I don't know if I'm going to -- we're going to name 3 things, but well, Michael, the DCs that we brought up are the DCs that we want to talk about today. And some of those happen to be retrofits. Springfield is moving an existing DC into a larger location. Puerto Rico is obviously expansion, Mexico. You could call it expansion, you could call it retrofit. We are not slowing down our DC growth. Our DCs, as we said, are pressured over the past 2 years.

We've pushed a lot of volume and a lot of years plan grows into 2 years doing this. And our DCs are pressured, and we're having to make sure we're doing everything we can to build them out to make them more efficient again. When you take a distribution center that's designed to service x doors and you're having to service x plus stores out of that box, it's not going to be as efficient as it's in its sweet spot. So that's adding some pressure to DC costs, which in turn, impacts our gross margin. So that's 1 thing, just getting our DC network built back up to make it more efficient. You talked about national brands versus proprietary brands. We still see opportunity to grow our proprietary brands, both here in the U.S. and in Mexico.

And the more we can expand those proprietary brands, the more opportunity we have from a margin standpoint to leverage suppliers and almost every 1 of our proprietary brand categories, we have multiple suppliers. That helps us leverage from a pricing or cost standpoint. It also helps with risk mitigation. If a supplier A, can't build this part for whatever reason, we go to supplier B to build that part.

So I think it's just things that really impact cost of goods sold is the bigger thing. I think the pricing is going to be what it is. We're going to price to market and try to continue to make bigger margins. That's a goal for us to drive operating margins to Jeremy's prior comment.

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

The only thing maybe I would add there, Michael, and I'd be remiss if I didn't say this, I would say stop me if you've heard this before, but we took the microphone away from you. So our focus is not on the gross profit percentage. We're going to drive gross profit dollars banks like to accept the dollars, the percentages are harder to deposits. So -- but I think to Greg's point, our focus is on how do we best create good value for our customers, how can we leverage the brands and our ability there, how can we be a better partner to our supplier base because of all the things that we bring to bear and get advantages there.

But the professional pricing initiative is a clear indication that our focus is on how do we drive gross profit dollars over the long term, and that's where our focus will be.

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

Michael, the other thing I would say, operationally is if you ask the guys on the back row back here, but they would tell you the biggest opportunity we have operationally is do a lot more retail business. And I think it's important to remember that what we talked about earlier that us coming from the professional side of the business, even though we do a nice DIY business, we're proud of. Our team is on the street every day. They're adding up -- they're sitting across the street from normally 2 great retail companies and then a professional company that still does quite a bit of retail business and even the independents to some degree, some of them do some walk-in business.

For lack of a better way of saying it, they're looking at our revenue monthly or annually in that store, and they're thinking of all this retail business that our big competitors are doing on that same street even though we all feel like the professional may grow incrementally faster than the retail business in my lifetime, we have a significant amount of DIY business to make O'Reilly. And you all can guess the disparity between the margins and the 2 businesses, and I wouldn't want you to forget that either.

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

Yes. And Michael, maybe just 1 other one, too. proprietary brands SP1 Yes, just back to the proprietary brands. When you looked at that slide, right, several of those, we've got great, good, better, best offerings within those brands. We've developed but you've got a couple of those brands, SYNTEC, Murray, Precision, those were national brands years ago, and now they're brands that we own exclusively. So we've just -- our team has done a fantastic job of that, but we're well positioned with that portfolio for continued growth.

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

Zach Fadem, Wells Fargo. Sticking with the rule of 3 here, can you walk through 3 opportunities from EVs and 3 threats from EVs?

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

Well, I can start -- I don't know if I'm going to get 3 and 3. You guys are being tough. You're quantifying my answers here. EVs, okay. So here's what I would tell you. We are working very closely with our supplier base on the evolution of EVs, and many of those suppliers are also OE suppliers. So they're there with leading-edge technology, they're providing to the OEs to make sure we have components in the aftermarket. I'm not sure I'm going to get 3 and 3 Zach. But obviously, there's no internal combustion engine in an electronic vehicle. We sell a lot of oil changes.

What I would tell you is, aside from that type of maintenance internal engine components is a declining category for us. Engines are built so much better than they were 10 or 15 years ago. The gasket sets, the pistons, the rebuild components is a declining category anyway. So from an internal combustion engine perspective, yes, that component is gone, and there's not going to be the oil changes. So that would be one, the pressure on that.

Before I continue on, I'm going to tell you my opinion on that. I think the pace at which EVs are adapted or adopted is much lower than what a lot of people are expecting or projecting I mean, when most of the people in this room probably live in larger metro markets, that the EVs work pretty well in those markets. When you get out into rural America, out into the Midwest, where people are pulling boats to the leg, people are driving a lot of miles. The EVs are going to be more challenged in those markets.

Back to your question. On the good side, I mean, there's trade-offs. I mean there's -- and I can talk about this literally all day long. There are also a lot of additional cooling components to EVs and we're working very closely with one of our suppliers on that.

So even though you don't have Internal combustion engine, now you have multiple electric motors driving that vehicle, multiple electric motors and a very large battery pack result in a lot of heat generation. So you have to have the cooling systems on EVs are going to be much more elaborate than what they are on internal combustion engine vehicles. So that category is good for us.

Brake category is kind of up in the air. When you start talking about Tesla and some of the initial EVs that came out, they had single-stage motors, some of you may own those vehicles and drive those vehicles, you led off the accelerator of the vehicle naturally slows down. which is a reduction on braking. Some of the higher end and emerging EVs, especially some of the Europeans are coming out with multiple stage motors, which is essentially operating kind of like a transmission.

So when you get that to where you've got multiple stages and as you drive faster the ratios change, it also changes on the back end. So as you slow down, you don't get that same resistance slow. So breaking could be a wash in that category. I'm trying to think, Brad, do you guys have anything to add? I'm not coming up with 3 and 3.

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

Yes, I think what I would say, Zach, is we get a lot of questions on this and it may not be the best industry answer, but I can give you O'Reilly answer is me growing up in our stores. Everybody thought the sky was falling when cars went from carburetors to fuel injection. And same thing with how many ECUs or computers are on a car today. We sell all those fuel injection parts, we sell all those computers. And what we have to remember is that no matter what comes down the pipe, the way we focus on it is that's a level playing field versus our competitors, meaning no matter what comes down the pipe. We've always been what we feel like humbly the best at adapting to those changes.

Same thing with ADAS, the advanced safety that's now on vehicles, I mean that's a huge opportunity for us. We're doing training on it. We sell the equipment for ADAS, all these little things that a shop has to have make sure that all the lane departure and all these different sensors and things like that, we sell those parts. And so I think our biggest opportunity to Greg's point, we have to hold our suppliers accountable.

We're all in this together in the aftermarket we know which suppliers are staying ahead of this. There are some that maybe aren't so much and we're watching that. But I would even go back to the slide I talked about where we help our shops, make sure that they're competing on this level. We have EV classes. We have ADAS classes. And so I would just answer -- I know it's a little bit of a nonanswer, but I would say more how are we going to perform under the existing circumstances that happen as time goes on. And I have confidence in our ability to adapt and figure out how to do that in true O'Reilly fashion.

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

It's more than just EVs. It's the whole emerging technologies of the vehicle. And to Brad's point, it's truly nothing new. It's just this step change is a little more dramatic with the -- my personal opinion is hybrids are probably going to be a bigger interim step and a bigger long-term part of the car park than pure EVs. There's a lot of things that drive this. And again, we could talk about this for a long, long time.

But even if right now, EVs are in 15% of the car park. If you look at the vehicles that are being sold today to get up to be a large percentage of the car park, it's going to take a lot of years to get us there. So my message is we're taking this very seriously from an emerging technologies perspective and specifically EVs. Brad talked about sensors. These EVs and hybrids have more sensors on them today than cars did 5 years ago, but so do the gas internal combustion engine vehicles. Those create additional sales opportunities for us, not only the parts for the vehicles themselves, but also all the calibration parts we sell the professional shops to -- I mean, if you have a windshield replaced in a vehicle today that's got a lane-keeping system on it, it has to go through a calibration.

I mean all those cameras have to be recalibrated just to have a windshield replaced. So it's getting much more technical and complicated and we're just doing our best to make sure that not only do we have the parts for those vehicles, but we're training to technicians and giving them the products they need to be able to work on those vehicles.

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

I think we got 3 and 3 in there. So just a follow-up question on your addressable market. When we sat here in 2019, and we talked about your TAM, you were calling out about $100 billion. And today, $135 billion. So the question is how do you reconcile the 40% step up 35%, 40%, whatever it is? How much is Mexico? How much is DIY versus Pro. Any -- how much is inflation? Any thoughts there on those buckets?

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

Yes. I think it's a combination of all the above plus just the way we look at it. We dug a little deeper into the makeup of the aftermarket, and we looked at the aftermarket sales that go back to the dealer. And we just really dug a layer deeper into that. Part of it is inflation. Part of it is just growth of the industry. And part of it, we probably didn't allocate enough 3 years ago to what that number should have been.

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

Daniel Imbro from Stephens. Greg, over the last couple of years, higher used vehicle prices, you talked about kind of incentivizing consumers to invest. I mean you've been through multiple vehicle pricing cycles. As we enter a couple of periods of prices moderating, how do you think that impacts your consumer, their willingness to invest in the vehicle? And then how do you reconcile that? Does that matter more? Does the lack of new vehicle production matter more? Kind of how do you think about that factor?

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

I mean I -- you got to remember, our key customer, our niche customer is not the customer that buys a new vehicle every 3 years. So what this cycle we're going through really does as far as our business is it keeps more vehicles out there on the road. It's more maintenance cycles. It's more breakage, more wear and tear, as I said in my prepared comments. We all know that at some point, things are going to catch up and new vehicle sales are going to pick back up.

And there's a portion of the consumer, while it's not our key customer base, that's going to start buying new vehicles. I don't see the average age of vehicles deteriorating when that happens. I see it maintaining or maybe even continuing to grow. It's just incredible. I talked about just a minute ago to Zach's question the internal engine component category decline, that used to be a key category for us. We used to build engine kits specific to rebuilding engines and sell a ton of those. Engines are built so much better today and vehicles are built so much better today that I think they're going to continue to be on the road. Not to mention the paints have improved. Everything about the car has improved. I mean you go -- you get second and third owners of vehicles now driving cars that look really good.

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

And that ties into the follow-up. I was going to ask because vehicles last longer, your sweet spot is probably getting older and older. I would say, can you quantify how far into a vehicle life cycle. We -- if it used to be 12, 13 years with the end, are we now 15, 16? And then from a working capital or supply chain standpoint, what does that mean for SKU availability, working capital, DC space? How do you reconcile or manage through that as vehicles last longer?

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

Yes. Jeremy, I'll let you chime in, too. On the life cycle, it's pretty easy when you look at that "sweet spot" to figure out where it starts. It starts when the vehicle comes out of warranty, whether that's 3, 5 years. That's when it really enters the aftermarket, and we really start selling more products for those. As far as the midpoint and where that tails off, that's a moving target. And I think it depends on a lot of different things. And really your first question is what it depends on what happens with new car sales.

How many people have learned during this pandemic and the unavailability of new cars that, hey, I can drive my car for 6, 7, 8 years. It still looks good. I don't have a car payment. This works pretty well for me and my family and my budget. How many people adapt that versus trading every 3 years. So there's a lot of unknowns there. Jeremy, I don't know if you have anything to add?

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Yes. I mean I think the right way sometimes we talk about it being a sweet spot. There are a range of years in which the investment in vehicles for us is really good. I think probably what you're saying is there's some extension of that for sure. But likely, the benefit is also coming from the degree to which people are willing to spend more money later into that existing time frame. 12-year-old car, people would invest in 3, 4, 5 years ago. They were built really well at that point in time, too. Today, they're probably willing to invest even more on a more substantial repair or on a higher quality item when it comes time to repair, they'll be able. Because now there's a better expectation, not just for whether that vehicle can stay on the road for the next year?

Or am I thinking about a trade or a replacement decision, but even for an extended period of time beyond that. So it's not, hey, there's a range of years when people spend on their cars and then they stop. It's really a spectrum of how much people are willing to spend. And I think that's been aided both by the cost of replacement on new vehicles.

But maybe back to the earlier question, what we see is that as people start to make those increased investments, there's a great positive feedback to that. It works well and becomes pretty sticky in vehicles do look well and you don't have a lot of decisions around -- I mean I just spent $400 for my car and now I got to get rid of it because something else has happened. No, it's man, I was able to keep my car on the road, and I've missed car payments for 6 months. And that builds on itself. And I think that's the positive that we see -- we expect to see it kind of in this market environment, but for sure in previous markets. But you don't see the vehicle -- average vehicle age pull back after it's pushed back up That's a sustainable phenomenon.

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

Yes. And Daniel, I would probably just add on the supply chain side of it. that product life cycle slide just talking about how we bring products into the life cycle, how we manage them through the life cycle. That's not -- we don't manage them on a vehicle on a year basis. We manage them on an individual part on a demand basis.

So the alternator for a truck that's 15 years old may fail pretty consistently and the demand may stay out there. We may keep that partner our supply chain much longer than we would the axle for that vehicle just based on failure rate. So we're looking at it on a part-by-part basis throughout the life cycle.

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

And that's a good thing for our business. It's always been challenging to manage the number of SKUs it takes to be successful in our business. That every year, that gets a little bit more challenging, but that's a positive for us because of the advantages that we have to the marketplace. -- an availability perspective.

Steven Emanuel Zaccone - *Citigroup Inc., Research Division - Senior Research Analyst*

Steve Zaccone from Citi over here. I had a question on for the Pro pricing investments. Could you talk a bit more about why you took those measures and why some learnings from it? And then what's the confidence that you don't need to do it again next year?

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

Sure. I'll start with that, Jeremy, may add. I know Brad will chime in from his perspective on the stores. It's -- our industry continues to evolve and our competitors continue to get better. We continue to get better. Our competitors continue to get better. There's more transparency today on the professional side of our business than there ever has been in the history of our company and our industry. Our competitors have transparency. They know who has the part. They can look on one screen tell who has the part, what it costs, how long it's going to take to get there. And they're making decisions, especially in the pricing environment we've seen over the past 1 year, 1.5 years with the inflationary component.

I think that people are looking at pricing a little more than they have. I'm not saying that's the key buying decision because 100% is not. What we've built our business on from day 1 has been service and inventory availability. That is more important to the professional installer customer 10x out of 10 than price.

But when you get into a market where you get 4 options and they all 4 have the part, they all 4 perform well, I think in this environment, some of those customers look at price. And often, the other piece of that is they're not only looking for a given part, they're looking for a job. So these shops don't always go to their suppliers and say, I need this part. It's I need these 3 parts to complete this job. And who has all the parts and who can get them here to me the quickest. That's first.

Price is secondary. So the reason we did this is because in the environment that we're in today and the fact that our competitors continue to get stronger, we want to make sure and keep ourselves in a position of leadership. And we looked at this really hard.

This started a couple of years ago when we went out and we started testing what's the impact to sales, what's the impact to margin. If we do make some pricing adjustments very scientifically within certain categories within certain SKUs within those categories, what's the impact? We tested in multiple markets for an extended period of time, and we learned that there is a sales lift associated with that. And there is a margin impact associated with that. We're very transparent about what our expectations were when we made that change. We feel very confident it was the right thing to do. And if we had it to do over again, we would have done the same thing again. I'll tell you that our plan is this onetime adjustment. It's not something we plan to do year-over-year. Although I'll tell you that since the beginning of time and more so recently as we've had better tools, we're constantly adjusting prices, both on the retail and DIFM side.

We're adjusting them up and we're adjusting them down. There's always changes going on to our pricing, depending on buying habits, depending on buying volumes, depending on customer size. There's a lot of decisions to go into how we price products for our customers. I'm not saying there won't be any price changes. But there we have no plans to make additional significant changes like a program change that we made earlier this year.

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Maybe the only thing that I would add to that, I think Greg touched on it. It's been a pretty turbulent couple of years within our industry. Because this has been a strategy of winning first on service and availability. It's been core fundamental to our business and our philosophy from the time our company was founded. So at any given point in time, we could have positioned ourselves a little bit lower on the spectrum of where the market price and the way that we have now and execute a different strategy.

We think that within an environment where we saw a lot of share moving around, we had opportunities to be in shops that maybe we weren't in as often before they're paying because we had supply because prices were moving quite a bit. We had a lot of focus on it. I think it helps to remove some of those barriers to continue to grow and to impact that business.

When you've got a lot of turbulence in the market is, I think, is shifting around a little bit more than there's a little bit more of an opportunity, I think, to roll something out like this and see the benefit of what you get. Because we have been getting more opportunities to prove the value that we have from a service and availability standpoint. And then as we have that momentum behind us over the -- of course, the last couple of years, we can take this next step to further capitalize on that and really secure some of those things and maybe take it to the next level past where we've been today.

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

Stephen, the other thing I would say is when we break down the addressable market and our operations team really looks at that share by market and what that is and really the quality of the share dollar this is generally speaking, but if you broke down a Nashville market or in Atlanta or New York or a larger metro market, most likely the independent competitors, not our large public competitors, would probably have over half that business.

You probably heard us say that before that the public just doesn't know that the biggest professional competitors we have in Nashville are not our big competitors. While they do a great job in so many different ways, those independents really hold a lot of that share. And so a big factor in our decision-making with that is we saw some -- the best independents, I mean, they're going to thrive for the most part in any market. But we saw some volatility in the market from maybe how some of the independents were servicing customers the last couple of years. And there's always been a big disparity between our price from a 3 step, from our supplier to our distribution center to our brick-and-mortar stores that you'll see today.

These independents are what we call 2-step. They're going from the supplier to a WD-type warehouse, and they're delivering directly to the shop from that WD type warehouse in a market like Nashville, for example. And so they can -- even though they don't have the buying power we do, they can be pretty competitive even, just quite frankly, quite a bit cheaper than us in a lot of those circumstances.

And we just saw a mid- and long term, obviously, short term to some degree, but more so a mid- to long-term play of a onetime change to Greg's point of the framework of our pricing. We'll always have prices that by SKU, by line, move around within that framework. But we saw a very strategic mid- to long-term play that we thought about for 2 years. We ran a lot of tests. We used a lot of data, a lot of science. It just so happened that it coincided with another change of our biggest retail competitor. But I wouldn't want anybody to think about it us battling it out with the top 3. It's really a play that we see significant share gains on the DIFM side of the business from continuing to consolidate the market with all the fragmentation with the independents.

Steven Emanuel Zaccone - *Citigroup Inc., Research Division - Senior Research Analyst*

Great. That's very helpful. The follow-up I had was just on the store growth plans from here. How do you think about M&A versus organic? And then I think the untapped markets in the Northeast, that's kind of been there for some time. How do you think about increasing your store penetration there?

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Yes, I can maybe start that question and then others can chime in as we can. We think that the success of how we've been able to grow organically over the course of time has really been dependent upon our ability not just to find good locations for our stores, but how do we develop the store teams, the infrastructure within the markets and then the individual store teams that we put in place. So we continue to still feel like that's the advantage. And we felt just really, really good about our ability to grow organically. I think there's continued opportunity for us to be able to do that.

We are underpenetrated in places like New England and probably still Southern Florida, in those areas. We could more heavily concentrate and try to ramp those numbers up more quickly in those markets, but it starts to work against our strategy of making sure that we can grow stores and spread that growth out well enough.

So that every time we open an O'Reilly store, we've got a great team within the store is going to provide excellent service and put us on the right footing in that market. So continue to feel like that those opportunities are in front of us. We think that there's capacity with within the existing United States to do that. But then also, we're always opportunistic from a consolidation perspective as we think about acquisitions. We like the value that we get when we're in a specific market from the people that are familiar to that market and have got the relationships in and sold parts to the consumers in that market for a long period of time. You can look across the room and in the back.

And we all have folks in the senior levels of our company that came to us from an acquisition, and we'll continue to focus on those. But those are always going to be things that we have to be opportunistic about, it's the right time frame in the life cycle of the ownership of that business and where we're at from a market perspective.

And I still think we have opportunities to fill in, in pockets there. And then that's really domestically Brad talked about. We still think we have got a great platform in Mexico to grow there, and that will be part of our strategy as we move forward. But maybe I'll pause there and see if anybody else wants to jump in.

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

Yes. I think, Stephen, if the acquisition opportunity with Mayasa had not come up, you might have seen us accelerate into that gap in footprint that you're talking about there. Quite frankly, being transparent when the Mayasa opportunity came up, it was a perfect opportunity for us. And one thing we didn't want to do with that opportunity is we were very cautious with our team in Springfield, our leadership team that though Mayasa is kind of a stand-alone company that had an incredible leadership team down there, we didn't want to take our eye off the ball of anything we had going on in the states here.

And so we focused our really our resources and time on the distribution things that Brent Kirby talked about earlier. So obviously, we're very excited about those markets that you're talking about, great markets.

One thing that we probably don't talk about enough is even though you may not see the headline of a big acquisition, we buy single stores almost every month that we're acquiring and picking up great teams, local teams and great partnerships on that front. But we're -- those markets of Washington, D.C., Philadelphia, Baltimore, City in New York City are incredible opportunities for us, and we're excited to tackle those down the road.

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

The only thing I might add is I think there's a better opportunity probably for M&A outside the U.S. as we expand into further into Mexico and potentially other countries. That's the way we prefer to enter areas where we have unfamiliarity. Not to say there won't be additional mergers within the U.S.

To Brad's point, we buy stores throughout the year. And some of them are single stores, some of them are 3, 4, 5 store chains. We have someone dedicated and focused on developing those targets here in the U.S., and we have someone focused on international as well. So don't plan on slowing our growth.

Elizabeth Lane Suzuki - *BofA Securities, Research Division - VP*

Great. Liz Suzuki, Bank of America. Brent, you had talked about the rewards program earlier. Can you just give some detail on how long the current program has been in place what you've learned about customers with the segmentation that you've built out? And then which marketing strategies have been working versus which might not be working?

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

Yes. And the program predates me, Liz. So I think it was around 2012, '14, '12, '14, so somewhere in that range. So maybe a little less than 10 years or so. But again, we have a segmentation. What we see there is on the retail side, again, we feel like our program is very simple. We did that by design and we continue to see good adoption by customers.

They like the simplicity of it. And we obviously, we look at trips and ticket within the segmentation, and we've seen trips grow and ticket grow over the past several years, that's accelerated somewhat. But I think more than anything, it's really about engaging your most loyal customers in a way that's meaningful to them that they get value from. And listen, loyalty programs are a dime a dozen. A lot of companies have them. Our goal is really to constantly get feedback from those customers and to make sure that we're evolving the program in a way that adds value for them. So that's kind of how we've gone about it and probably even more in earnest over the last several years, and we feel like we're getting a good result from it.

Elizabeth Lane Suzuki - *BofA Securities, Research Division - VP*

And just as a follow-up about the anecdotes and surveys we may have all seen about people delaying maintenance as inflation has put more pressure on their wallets. How are you fighting against that with marketing efforts and with trying to stay connected with your customers who now have more data on?

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

Yes. So we do look at the data. And to your point, we've gotten more effective and efficient on using our customer data over the last several years, and we're continuing to work to have kind of a golden customer record for every touch point they have with our brand. But what we've seen is certainly lower end consumer, especially during the first half of this year, we've seen some pressure there. So we've adjusted our value messaging accordingly. Customers are looking for value. They still have to maintain their vehicle.

They still have to change the oil. They still need filters. So we adjust our messaging accordingly when we go through those kind of cycles. But we also continue to see strength with -- and it's interesting. Everybody always tries to compare this downturn to the last downturn, to the last 3 downturns. The reality is this one is a little bit different. Because of COVID, some of the stimulus that's out there, different things in the -- that are at play.

What we see is the shops are still doing well. We have customers that still have money and they're doing very well. They're still investing to maintain their cars. So we've seen the strength on the professional side of the business. We have seen some recent pressure on that lower end consumer. We're adjusting our messaging to adapt to that. And quite honestly, our product offering lends itself to those cycles. I mean we've been through those before. We have good, better, best offerings for anybody that's on the budget that has to maintain their car. And we also have an offering for somebody that has a little bit more means to put more money into it.

Samuel Castleman Harvey - *Harvey Investment Company, LLC - President*

I have one. It's Sam Harvey, Harvey Investment Company. I assume when you do build either a greenfield or refurbish distribution center, there's a calculated return on that based on the store build-out and the profitability per store. And you have a level of confidence or certainty maybe even about the return you're going to get on that. The return on the DC in Mexico, do you have any different sense of uncertainty about that when then you do to ones that are here in the United States.

Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Yes. It's good question. Over the course of the last several years, even prior to our acquisition in that market. But then certainly, once we acquired our partner down there and began to learn more and more about our business in Mexico have felt comfortable that we can invest dollars not just in distribution, but implicit and by building a distribution center is all the stores that are going to come after it. We felt good about the potential to gain returns. We don't want to get into the details of how we think about the return profile there versus the United States.

We haven't drilled down to that level. But we've made a commitment to that market. We made it with both the acquisition and then moving forward. So are there unknowns to what we see down there? Yes, of course, there always are with DCs. But we feel that we've been able to get a good enough handle both before the acquisition and what we've seen since and how we started to open some of these product-type stores to have a high level of confidence that we can successfully deploy capital in Mexico and get returns that we're happy with.

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

Yes. It's a key component of our growth strategy. I mean we bought that company. They had 20 stores small DCs for us to grow to the scale we want to grow in Mexico. And we feel like we can operate 600-plus stores down there. We have got to have distribution capacity to do so. So we work very closely, and I'm not talking about the financial component, more about it's a conduit to growth for us, both here in the States and in Mexico. So we went out, we determined how many stores we need to service in that general marketplace in Mexico.

And that's a little different scenario than it is here in the States. We've got algorithms that say, okay, we know here in the states based on traffic patterns, which we have a lot more data on. Here's how many miles we can service from that DC, turn our trucks every night, do these nightly delivery models. Down there, traffic is a lot different. And that pattern is a little bit smaller than what it would be here in the States. But we know how many stores we need to be able to service in that market and size that DC accordingly. So that is a key component of our growth strategy in Mexico. It's having that DC there to support that number of stores.

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

Yes. And it's bringing our parts availability model to that market. And there's tremendous market down there. We know that. And to Greg's point, we couldn't bring the availability and the replenishment frequency that I talked about with our distribution strategy to that country and grow that store base without adding that DC.

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

And just keep in mind, too, Mr. Sam that we acquired an incredible company. Even though we're new as O'Reilly in the Mexican market, the family and the leadership team that we acquired has 3 generations of experience in the market. And so they have all this knowledge of the market.

They know the -- what to do and what not to do. And when you combine that with our backing and their knowledge of the markets, it's just really going to be a great recipe for success. So even though O'Reilly is new to the market, -- we have a leadership team down there that has tremendous knowledge and they've been doing business in the auto parts business down there for just a decade after decade.

David Leonard Bellinger - *MKM Partners LLC, Research Division - Executive Director*

David Bellinger with MKM Partners. You highlighted a lot of the technology investments in the back of the store. So how much of the professional business is conducted on your B2B platforms should that grow higher? Maybe just talk through some of the efficiencies you can tap into if more orders are placed onto your platform directly.

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

Yes. Thanks, David. That's a great question. We've never quantified the percentage of the revenue or tickets, but I can tell you, it's significant. We've been doing B2B business electronically again, since I started with the company in '96, even though it looked a lot different. But it's a tremendous opportunity for us.

When you think about pressure on wages, not just on our side of the house with parts people, but with the shops and having technicians and having service riders that were tied up previously on the phones and things like that. It's a tremendous opportunity for us. It's a very sizable piece of our professional business. We have our what we call our first call online that Brent mentioned, that's our -- basically our free web browser, the smaller shops, midsize shops would used to connect to us. And again, they kick out that big ticket. So we're taking the phone call out of the equation. We're taking work on our side and their side out of the equation.

But we also have a unique partnership with a company called Mitchell 1 that would be our shop management system. So it would be above and beyond the browser that's that shop -- that we're utilizing our shop management system that they run their shop on. And then that's even stickier than First Call Online, so to speak. And it's tremendous.

We've seen tremendous growth, like Brent talked about in the amount of transactions and the percentage of the business that's done online. But it's still not the majority. It's still -- there's still a lot of things that happen as you'll see in our stores today, and I think you have previously, there's still a lot of the trust factor. There's a relationship with the person in the back of the store that you'll see today. And so it's a huge opportunity for us. It continues to grow. We're excited about it, but there's still that relationship factor that's incredibly important as well.

David Leonard Bellinger - *MKM Partners LLC, Research Division - Executive Director*

And just one other unrelated one on supply chain. I think the last time we talked about there's about 30% to 40% of imports directly from China. So have you rethought that at all or taken any measures to provide the business away just to potentially avoid from any further issues down the road?

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

We have. I'll let Brent take that.

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

Yes. So we have talked about that. And obviously, like a lot of companies, we've seen some of the pressure, China specifically. But we've done a lot to diversify that supply chain and that dependency over the last couple of years, especially, and we've continued to source products from other countries and even domestically from suppliers that we weren't necessarily buying from before. So yes, I think we've had certainly a focus on further diversification there. And that percentage actually has gone down as a result.

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

Yes. It's right at 30% now out of China -- or yes, out of China. It's not just changing suppliers that are coming from other countries of origin but also working closely with our suppliers to diversify their country awards and offering. We've got suppliers that have traditionally manufactured products solely in China that have plants in China, Taiwan, Vietnam, India, other places, we continue to press them to diversify country awards and for that very reason.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Thanks that was actually going to be my question. So just to expand upon that, are you also focused on holding more inventory locally at all? Or is it just the concept of maybe diversifying the total supply chain.

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

Yes. So I'll start that. I don't know, Brent, if you want to chime in. I mean our strategy with our direct import suppliers. We like, prefer, we don't mandate, but we prefer for our suppliers to have product state side. So it's not us typically what -- now the last 2 years, this is not working as well as it has historically. But ideally, we're replenished from many of our import suppliers out of a domestic warehouse and they're replenishing that from China.

Some of our fastest-moving SKUs, it makes sense to bring those directly into our -- either our owned or leased 3PL facilities. So it's a combination of direct importing into our larger DCs directly importing into our operated 3PL facilities and replenishing our DCs and primarily replenishing into supplier-owned U.S.-based facilities to replenish our domestic DCs.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

And then also, I just wanted to touch on you talked about expanding into Puerto Rico, you're expanding your Mexico business. Can you -- and you've mentioned this before, but can you just elaborate on your decisions to do that versus maybe what another competitor did by going into Europe?

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

I'll tell you that we haven't excluded any part of the world for -- as an opportunity standpoint. We've looked at different geographic regions. The reason that we started in, let's say, North America and we're looking at primarily Canada and Mexico is a very similar supply base, a very similar car park. And we didn't go into Mexico, to Brad's earlier point, and start opening stores as O'Reilly stores because we just don't know that market.

That's why we looked at several companies from an acquisition perspective before we settled on Mayasa. We like that company. We like the family feel of that company. We like the culture of that company. It felt much like our company when it was much smaller. So we're leveraging their knowledge and their strength in the marketplace to allow us to grow down there. I would anticipate as we move into other international markets, we would try to take the same approach.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

And then just the last question. You talked about the transparency kind of increasing in the B2B over the last 5 years and maybe that was partially impacted your decision around pricing. The original question maybe 5 years ago around DIY omnichannel was -- would it increase pricing transparency. As we've kind of had that discussion over the last 5 years? What have you learned? And you went over some really impressive changes to your omnichannel techniques. Can you just kind of talk about what you've learned and what you're seeing still there?

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

Brent, do you want to take a shot?

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

Yes, sure. What I would tell you is we've learned that price transparency has increased across both DIY as well as professional. And a lot of that's just digitization of the economy, how we all consume information, phones and what we can get quickly through a digital interface. So -- that's been the learning. What we've done about that is we work to improve our content, which improves our value proposition and how we show up when customers do come to us for those inquiries so that we present our best foot forward with our product and how to purchase the product. And I mentioned images, specs, all that stuff is tremendously important in our space because, again, you're solving a problem. And it's usually not discretionary.

You're looking for who has the part the fastest. So we've done a lot because of that transparency on content. We've done a lot on search. We've made a lot of IT investments to support the increased traffic and how customers interact and to provide a really good interface, whether it's mobile or whether it's desktop. Our mobile traffic has grown exponentially. As a result, we've invested more in how we optimize our site for mobile and for pads. So I would tell you the learning is it's here to stay, and we're going to compete effectively with that dynamic.

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

I think the other thing to remember on the transparency part is it's not just price. We -- the investments we've made on -- in our service levels with technology in the back of the store and with the handheld devices that are delivery drivers carry, for example, our shops, when they're looking at our first call online, they can actually track their parts and see where they're at in the vehicle. And so it's not just I wouldn't just focus on the pricing transparency. A lot of our strategies have been how can we take professional parts people to the next level from a digital standpoint and they can track those parts.

So they can see that maybe they're 30 seconds away from the shop, and they can go ahead and roll that car into the bay or they may see those parts or 10 minutes out and they may want to roll something else in real quick. And so -- when it comes to the omnichannel world, especially on the B2B side, it's not just price. It's how can we truly be a better supplier from an omni standpoint and a lot of that service as much as it is price.

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

To Brad's point, even on the retail side, I would maybe even add to what he said. It really is in our industry, it's about the marriage of the 2, the digital interface interaction as well as the interaction with our store and our team members. -- we rolled out a couple of years ago, we rolled out dedicated pickup locations on the front counter of all of our stores so that customers can come in and get their buy online, pick up in store order more quickly, more efficiently. That was a big investment.

We also rolled out curbside when COVID hit. We took that out into the parking lot, working with Brad and his team to provide a better customer experience for those customers to on the retail side. He mentioned the professional, which we've given a lot of transparency there. So it really is about how we meld the 2 together. And when it comes to transparency, it's really about -- it goes back to the core of our business, which is parts availability, professional parts people. in service.

Mark Merz - *O'Reilly Automotive, Inc. - Senior VP of Finance*

Okay. Well, fantastic guys. That's a great way to wrap it up today. Just one quick comment. We didn't specifically have a slide in this deck specific to ESG, and I know this is a very high visibility topic with the investment community. I want to assure you that this is extremely important to the company as well. I would encourage all of you to visit our website. We've just released our fourth annual sustainability report. And in that report, we have an aspirational statement to comply with the conditions of the Paris accord and be carbon neutral by 2050.

We've also committed to establishing short- and long-term Scope 1, 2 and 3 goals. We will announce those targets in next year's sustainability report. And then each report after that, we will report on our progress towards those goals. Our Corporate Governance and Nominating Committee of our Board is the group that is responsible for monitoring the ESG components of our company. They have created a sustainability committee, which I'm proud to be a member of the management of the company. And this is an extremely high focus for us. ESG for us has always been part of our culture. Just in the last couple of years, it's gotten an acronym, but it's very much a part of who we are.

So with that, we're going to end the webcast for today. We'd like to thank everybody for joining us here in person, and we would like to thank everyone who has joined the webcast electronically. If anyone has any follow-up questions, please reach out to myself or Eric Bird, and we're more than happy to answer them. So with that, we'll end the webcast portion of today's day.
