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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Welcome to the O'Reilly Automotive, Inc. Third Quarter 2023 Earnings Call. My name is Holly, and I will be your operator for today's call. (Operator Instructions)

I will now turn the call over to Jeremy Fletcher. Mr. Fletcher, you may begin.

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

Thank you, Holly. Good morning, everyone, and thank you for joining us.

During today's conference call, we will discuss our third quarter 2023 results and our outlook for the remainder of the year. After our prepared comments, we will host a question and answer period.

Before we begin this morning, I would like to remind everyone that our comments today contain forward-looking statements and we intend to be covered by, and we claim the protection under the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as estimate, may, could, will, believe, expect, would, consider, should, anticipate, project, plan, intend or similar words. The company's actual results could differ materially from any forward-looking statements due to several important factors described in the company's latest annual report on Form 10-K for the year ended December 31, 2022, and other recent SEC filings. The company assumes no obligation to update any forward-looking statements made during this call.

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

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

Thanks, Jeremy. Good morning, everyone, and welcome to the O'Reilly Auto Parts third quarter conference call.

Participating on the call with me this morning are our Co-President, Brad Beckham and Brent Kirby as well as Jeremy Fletcher, our Chief Financial Officer; Greg Henslee, our Executive Chairman; and David O'Reilly, our Executive Vice Chairman, are also present on the call.

I'd like to begin today's call by congratulating Team O'Reilly on outstanding results in the third quarter and express my deep appreciation to our team of over 88,000 professional parts people for their steadfast dedication to our customers. This unwavering commitment to excellent customer service is the hallmark of O'Reilly Auto Parts and the key to earning our customers' business every day.

Our team's ability to deliver sustained profitable growth is evidenced by a robust 8.7% increase in comparable store sales coupled with a 17% increase in diluted earnings per share for the third quarter. Our results have exceeded our expectations throughout the year driven by the team's high level of execution.

Service and product availability are critical pieces of our value proposition and our ability to remain intensely focused on these fundamentals has continued to drive growth on both the professional and DIY sides of our business.

As we announced in July, upon my retirement in January, Brad Beckham will be promoted to the position of Chief Executive Officer, and Brent Kirby will be promoted to the role of Company President. Brad and Brent are tremendous leaders who bring world-class ability, experience and passion to their -- I'm sorry, yes, and passion into their new roles. Even more importantly, Brad and Brent are incredible standard bearers of the O'Reilly culture, and I'm very excited about what our future holds under their leadership.

Our transition of the operations of the company to Brad and Brent has progressed smoothly and seamlessly and as a result, today's earnings call represents my last call as CEO. As such, it is appropriate for me to leave the bulk of our discussion of the third quarter results to Brad, Brent and Jeremy. But before I turn the call over, I would like to thank our shareholders for their continued confidence in and support of our company during my tenure as CEO.

Finally, I'd like to again thank Team O'Reilly for your hard work and commitment to our customers. It's been my absolute honor and privilege to work alongside you for the last 41 years with a front row seat to see you achieve so many incredible milestones along the road of success for O'Reilly Auto Parts. Even though I will get to actively participate in the next chapter of our company's success, I'm still very excited for the many opportunities ahead and look forward to watching our company's continued growth and future success.

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

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Thanks, Greg, and good morning, everyone.

I would like to begin by congratulating Team O'Reilly on another excellent performance in the third quarter. The ability of our team to deliver continued industry-leading sales performance requires a consistent and intense focus on our culture and the fundamentals of excellent customer service. I would like to thank all of our team members for their hard work, commitment and dedication to our great company.

Now I'd like to walk through the details of our sales performance for the quarter on both the professional and DIY sides of our business.

We spoke on our last call to the strong start to the quarter in July driven in part by extreme heat in many of our markets as we were pleased to see these very strong volumes carry on throughout the quarter. From a cadence perspective, we saw a similar topline outperformance in each month of the quarter as compared to both the expectations we built into our plan coming into 2023 and the updated guidance we provided on last quarter's conference call.

As we have discussed throughout 2023, our prior year comparisons get more challenging as we move throughout the back half of the year, and this dynamic was reflected in the cadence of our comparable store sales in the third quarter with our strongest comps for the quarter in July and

August. However, on a 2-year stacked basis, our performance was much more consistent through the quarter with September only slightly below the full quarter performance due to a moderation of the hot weather benefit we realized earlier in the quarter.

While we did see outperformance during the quarter in categories impacted by heat, such as cooling and HVAC, we also experienced broad strength in application-specific car part categories as well as maintenance categories such as oil and filters. These dynamics give us confidence that while we did benefit from weather, it was not the primary driver of our above-expectation results and the sales we are generating in failure and maintenance categories indicate a healthy level of broad-based consumer demand.

Our professional business continues to be the more significant outperformer and our team was able to deliver another quarter of mid-teens comparable store sales growth in our professional business in the third quarter. This outstanding growth was in line with the professional sales increase we achieved in the second quarter while facing increasingly challenging prior year comparisons.

We are extremely pleased with our team's ability to gain share through consistently executing our business model and providing industry-leading value to our professional customers. Our expectation is to continue to grow our share in the professional business as we see plenty of opportunity in both new and existing markets to consolidate the overall DIFM market.

Turning to our DIY business. We were pleased to generate solid comparable store sales growth with our topline growth consistent with the first half of the year, even as we saw an expected moderation in the benefit from inflation. In line with the trends we have seen this year, our DIY comparable store sales growth has been driven primarily by increased average ticket values. However, we were pleased to see positive DIY ticket count comps in the third quarter.

Our teams continue to execute our dual market strategy, driving market share growth in our DIY business alongside our robust growth in professional. However, our portion of the total DIY market share in the U.S. is still relatively low, and we see continued DIY growth as a tremendous area of opportunity for our company.

Now I would like to provide some color on our average ticket and ticket count performance. Average ticket growth was again in the mid-single digits on a combined basis and with slightly larger -- was the slightly larger share of our comparable store sales increase. While we are seeing the expected reduced benefit from same SKU inflation as we move throughout the year, our moderation in total average ticket growth has not been as significant due to offsetting strength we have seen from parts complexity and product mix.

Moving forward, we expect a more normalized same-SKU inflation benefit but are confident that future average ticket growth will be supported by increased parts complexity, which has been the primary historical driver of our average ticket.

Even though average ticket growth was the larger contributor to our comparable store sales growth, we are very pleased with our ticket count comps, which was the larger contributor to the outperformance versus expectations. Our team's ability to outhustle and outservice our competition for this increased traffic volume is paramount to ensuring these share gains translate into repeat business. It has never been more important to ensure that we have highly trained teams of professional parts people supported by superior product availability in every single one of our 6,000-plus stores.

As I finish up our remarks on sales performance in the quarter, I would like to highlight our updated full year sales guidance. We have increased our full year comparable store sales guidance to a range of 7% to 8% from our previous range of 5% to 7% and increased our total sales guidance to a range of $15.7 billion to $15.8 billion. This update is reflective of our year-to-date performance through today's call including a solid start to the quarter with October trends in line with how we exited the third quarter.

As we finish out 2023, our fourth quarter reflects our most challenging comparisons of the year as we lap the 9% comparable store sales increase in the fourth quarter last year and expect to see a fully normalized same SKU benefit. Our outlook for the remainder of the year is consistent with the guidance we have maintained throughout 2023. While we have been very pleased with the degree to which our performance has outpaced our expectations in the first 9 months of 2023, we are always cautious as we approach the last few months of the year, which historically can be volatile due to variability in winter weather and pressures consumers can face during the holiday shopping season.

As a reminder, our prior year comparisons are the most challenging in December as we benefited from broad-based strength in weather-related categories at the end of 2022. Against this backdrop, we maintain a positive outlook on the fundamentals of our industry. We are confident that the key demand drivers for the aftermarket, including steady recovery in miles driven and a very favorable U.S. vehicle fleet dynamics are in place to support steady growth moving forward.

We also believe that our customers have remained resilient and are continuing to prioritize the maintenance of their existing vehicles in order to avoid taking on a payment for a higher-priced newer vehicle.

As you have heard from me already today, we see lots of opportunities in our markets to grow faster than the industry. Our team is charged up by the results we are seeing from our solid execution of the basic fundamentals of our business that translate to success.

Next, I would like to take some time to discuss our SG&A performance in the quarter. SG&A as a percentage of sales was 30.1%, a deleverage of 29 basis points from the third quarter of 2022, driven by an increase in SG&A per store of approximately 8.5%. Our SG&A growth in the third quarter was above our expectations, so I want to provide some additional color on what drove the results in the third quarter.

As we saw in the first half of 2023, the majority of our outsized year-over-year SG&A growth as compared to our historical growth rates was the result of planned investments and initiatives targeted at enhancing our long-term operational strength. Our spend on these items was largely in line with our expectations coming into the quarter, and we remain pleased with the positive impact we are generating by reinvesting in our stores, technology and most important, in Team O'Reilly.

While these initiatives continue to play out as planned, our total SG&A dollar spend per store in the third quarter was higher than we expected coming into this quarter. This was driven by incremental costs necessary to support our significant comparable store sales outperformance, but which also resulted in better leverage of SG&A expenses than we saw in the second quarter.

Our focus remains on relentlessly pursuing the excellent customer service that strengthens the long-term relationship we have with our customers, and we will continue to be aggressive where we see opportunities to accelerate topline growth and, in turn, create leverage over time, driving long-term returns.

Based on our results in the third quarter and expectations for the remainder of the year, we now expect to see SG&A per store increase 7% to 7.5% for the full year. With this increase from prior guidance, we still expect our full year operating margin to come in within the range of 19.8% to 20.3% of sales, driven by leverage on our strong topline results. Expense control remains as important to the O'Reilly culture as it always has, and we will be judicious in how we manage our spend to ensure we are seeing long-term results from the investments we make in the business. This focus on profitable growth has drove our 17% increase in third quarter diluted earnings per share. We are updating our full year EPS guidance to $37.80 to $38.30, representing an increase of $0.75 at the midpoint, reflecting the strong performance in the third quarter.

Before I turn the call over to Brent, I would like to again thank Team O'Reilly for their hard work and dedication to the O'Reilly culture. Greg has been a tremendous leader for our company, an incredible mentor to me and is a tough act to follow, but I am very excited for the future of our company and our entire team is committed to our company's continued success.

Now I'll turn the call over to Brent.

Brent G. Kirby - *O'Reilly Automotive, Inc. - Co-President*

Thanks, Brad.

I would like to echo Greg and Brad, in congratulating Team O'Reilly on the outstanding performance in the third quarter. The continuation of our strong sales performance and proven ability to outperform the market is a testament to our team's unwavering commitment to excellent customer service. I want to thank all of our team members for their dedication to our company, and to our customers.

Now I will cover our third quarter gross margin results, what we are seeing in the competitive environment and provide some updates on our store and distribution growth, inventory investments and capital expenditure plans.

Starting with gross margin. Our third quarter gross margin of 51.4% was 46 basis point increase from the third quarter of 2022 at just above our expected range. We are pleased with the stability of our gross margin results as our third quarter continued the strong trend we saw in the second quarter. Our gross margin for the third quarter faced pressure from the sustained strong performance in our professional business, creating a customer mix headwind, but we have been able to offset these headwinds through improved acquisition cost and outstanding support from our supplier partners.

Pricing to both DIY and professional customers has remained rational within the industry. We continue to see modest inflation in the third quarter and remained very successful in passing along increases in product acquisition costs and other inflationary pressures in selling price.

While our quarter-to-quarter gross margin rate can see normal fluctuations from seasonality and product sales mix and leverage of distribution costs relative to overall volumes, the stability of our results in light of the share gains we are experiencing demonstrates our team's ability to win share through service and product availability. As a result of our solid year-to-date performance, we are maintaining our full year gross margin guidance of 50.8% to 51.3% but would now expect to come in within the top half of this range.

Inventory per store finished the quarter at $758,000, which was up 4% compared to the beginning of the year. We would now expect our average inventory per store increase to finish the year in a range between our original guidance of 2% growth and the current levels, driven by our continued opportunistic investments to support our sales momentum.

Our AP to inventory ratio at the end of the third quarter was 134%, in line with the beginning of the year and slightly better than expectations, driven by strong sales volumes and inventory turns. We now expect to finish 2023 at a similar level.

The health of our supply chain and resulting store in-stock positioning continues to be a competitive strength, optimizing our assortments across our DC, hub and store network while simultaneously partnering with our supplier community to achieve industry-leading fill rates is absolutely playing a key role in our exceptional sales results, and we continue to regard inventory availability as a critical priority for our business.

Alongside the investments we are making in inventory, we also remain focused on leveraging the benefits of the tiered nature of our distribution model. This strategy has been an important aspect of our supply chain for many years and begins with placing distribution centers in large metro areas to provide same-day availability to a wide range of SKUs for our customers. Strategically located hub stores augment our SKU availability on a more localized basis and represent the very important second tier within our distribution supply chain. We continually evaluate this network, including the number, location and size of our hub stores to ensure that all our stores have the best access to inventory in their respective markets.

Next, I would like to discuss our capital investments and expansion opportunities, beginning with the investments we are making in our distribution network.

As we discussed on last quarter's call, we are very pleased with the successful opening of our Guadalajara, Mexico DC, in July, but are also excited on today's call to announce 2 additional expansion projects that we currently have underway. First, our distribution teams are actively working on a relocation of our Atlanta DC, which is a large project that will enable expanded, more efficient store servicing capabilities within that market as well as providing direct import processing capability within this new facility. This new 690,000 square foot building is expected to be complete by the end of 2024 and will increase the number of stores we can support in this critical market by 100 stores.

Next, we have an exciting distribution expansion project that is in progress in Stafford, Virginia, where we have purchased a site and began construction on a large new distribution facility that will service the Washington, D.C., Maryland and Virginia corridor. The new DC will be approximately 530,000 square feet and our initial plan is to build out capacity to service 350 stores. We anticipate this distribution center will be open and operational by the middle of 2025. And we could not be more excited about the store development opportunity this provides us in what is largely an untapped market area for O'Reilly today.

Our distribution center teams are diligently executing on these projects and are enthusiastically looking forward to further expanding our DC footprint and our industry-leading parts availability.

Turning to store growth and expansion. We successfully opened 40 stores during the third quarter, bringing our year-to-date total to 140 net new store openings for 2023. Our team is confident we will achieve the goal of 180 to 190 net new store openings for 2023. As we noted in our press release yesterday, we announced our 2024 new store opening target of 190 to 200 net new store openings.

Our strong new store performance continues to prove that our investments in both new stores and the necessary distribution infrastructure to support those stores is an attractive use of capital.

Total capital expenditures for the first 9 months of 2023 were $754 million, a considerable increase over prior year, but reflective of the attractive opportunities we see to deploy capital against projects and initiatives to drive long-term growth and enhance our competitive positioning. Included within our press release yesterday was an update to our full year capital expenditure guidance to a range of $900 million to $950 million from the previous range of $750 million to $800 million. The primary driver of this increase was the progress that we have made on the new Virginia distribution expansion project as well as a higher mix of owned and new stores and the pace of investment in technology and store infrastructure initiatives.

To close my comments, I want to once again thank Team O'Reilly for their hard work and continued dedication to our customers.

Now I will turn the call over to Jeremy.

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

Thanks, Brent. I would also like to thank Team O'Reilly for their continued hard work and outstanding performance in the third quarter.

Now we will cover some additional details on our third quarter results and guidance for the remainder of 2023.

For the quarter, sales increased $405 million driven by an 8.7% increase in comparable store sales and a $78 million noncomp contribution from stores opened in 2022 and 2023 that have not yet entered the comp base. Our third quarter effective tax rate was 23.2% of pretax income, comprised of a base rate of 24.3%, reduced by a 1.1% benefit from share-based compensation with both of the components of our rate in line with the third quarter of 2022. Our third quarter base tax rate was in line with our expectations with the total effective tax rate below our expectations due to higher-than-planned benefits from share-based compensation.

For the full year of 2023, we continue to expect an effective tax rate of 22.5% comprised of a base rate of 23.4% reduced by a benefit of 0.9% from share-based compensation. Our fourth quarter effective tax rate is expected to be lower than the other 3 quarters due to the tolling of certain tax periods. Variations in the tax benefit from share-based compensation can create fluctuations in our quarterly tax rate.

Now we will move on to free cash flow and the components that drove our results. Free cash flow for the first 9 months of 2023 was $1.7 billion versus $1.9 billion in the same period in 2022. The reduction was the result of the increase in capital expenditures Brent discussed in his remarks as well as a lower working capital benefit from reduction in net inventory this year versus 2022. These headwinds were partially offset by growth in income and a benefit from favorable timing of tax payments and disbursements for renewable energy tax credits.

For 2023, we continue to expect free cash flow at a range of $1.9 billion to $2.2 billion, with an increase in expected cash flow from operations offsetting the increase to our CapEx guidance.

Moving on to debt. We finished the third quarter with an adjusted debt-to-EBITDA ratio of 1.93x which is up compared to our end of 2022 ratio of 1.84x. The increase in total indebtedness was comprised of borrowings under our commercial paper program, which we successfully launched in the third quarter. We continue to be below our leverage target of 2.5x and plan to prudently approach that number over time.

We continue to be pleased with the execution of our share repurchase program and during the third quarter, we repurchased 852,000 shares at an average share price of $938.11 for a total investment of $800 million. Year-to-date through our press release yesterday, we repurchased 3.4 million shares at an average share price of $879.74 for a total investment of $3 billion. We remain very confident that the average repurchase price inclusive of the current excise tax cost is supported by the discounted expected future cash flows of our business. And we continue to view our buyback program as an effective means of returning capital -- excess capital to our shareholders.

As a reminder, the updated EPS guidance outlined by Brad earlier includes the impact of shares repurchased through this call but does not include any additional share repurchases.

Finally, before I open up our call to your questions, I would like to again thank the O'Reilly -- the entire O'Reilly team for their continued dedication to the company's long-term success.

This concludes our prepared comments. At this time, I would like to ask Holly, the operator, to return to the line, and we will be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question for today is coming from Michael Lasser at UBS.

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

Your guidance -- implied guidance for the fourth quarter implies a significant slowdown in the business. Outside of the uncertainty associated with the weather and the holidays, is there anything that you would point to that would have influenced such a slowdown or deceleration in the performance of the comp?

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Michael, it's Brad. I'll take a stab at that and see what the other guys want to follow up with. Great question. As you know, Michael, I think generally speaking directly to your question, the answer is not really. As you know, as we always say, the fourth quarter can be the most volatile from the weather standpoint, from the holidays. I think the key is just to remind you what I said earlier, that we feel really good about how October is going so far. Generally, the first few weeks of the quarter have been very consistent with what we saw with the exit rate, especially from a 2- and 3-year stack basis but we still have almost half the quarter to go. December is a huge comparison, and we just want to make sure that we're just being cautious overall. But generally speaking, we're really happy with the way volumes are holding up and really excited to do everything we can to finish the quarter strong here.

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

Maybe, Michael, the only thing I would add is just the characterization of a significant slowdown in our business. We've really spoken all year to just the timing of how that 1-year comp is going to look as comparisons just naturally get more challenging as we move through the year. While there is some time left in the quarter, and we've been pleased with our performance all year long, what we're anticipating as we finish up the year is pretty consistent with where we've been. It's not reflective of anything that we're seeing. When we think about our sales from a week-to-week volume, understanding the seasonality of the business as we move into the fourth quarter. Unfortunately, we're going up against some really tough compares, but that's also a good spot to be in. And really, nothing has changed in how we think about the current pace of the business.

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

I got you. For O'Reilly, tough compares is a way of life, but that's okay. My second question is on the outlook for SG&A spending, it's obvious that the returns on the investments that you're making have been quite productive in light of the market share that O'Reilly has been achieving. Would you expect a similar rate of SG&A dollar growth on a per store basis moving through 2024? Are there opportunities to invest such significant amounts that would generate similar returns?

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Thanks, Michael. Another good question there.

Well, as we've said, we're extremely pleased with the returns we've seen from investing back in the business. As you know, there's a big difference for us at O'Reilly between investments and judiciously managing our expenses. Like I said earlier, expense control is a huge part of what we do. We never like to delever except in the case of this year when we know that we're playing from a position of strength, and we knew there are some areas that are really just paying off. We're very happy with the ROI we've seen on all our initiatives where we've reinvested back in the business this year.

As you know, a lot of that is some catch-up from COVID, the years of COVID and everything that we wanted to spend that we didn't quite get to. So, Michael, honestly, we're in the middle of working on our plan for 2024. That always starts with the topline number, and then we back into what we feel like is the right thing to do for short, mid and long term, especially when it comes to those mid- and long-term returns. And so we look forward to talking about our plan in February '24, but we just want to be careful talking about '24 just yet.

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

Understood. And good luck to Greg Johnson. Thank you so much.

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

Thanks, Michael.

Operator

Your next question is coming from Bret Jordan from Jefferies.

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

As you guys continue to gain market share in the space, could you talk a little bit about where you're seeing both that coming from smaller DIFM independents or national accounts? And then, I guess, obviously, there's got to be a share donor as well. So is that also the smaller WDs that you're picking up from? Or are things changing in market share relative to larger peers?

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Thanks, Bret. Another good question. Honestly, Bret, as we -- you've heard us say for a long time, it's always hard to tell all the moving pieces. We have extreme respect for -- we take all our competitors extremely seriously. The big 4, the independents. We have tough, tough competitors on both the DIY and the professional side of the business. We spend our time focusing on where -- we are our own worst competitor, meaning that we always have execution opportunities. We always have areas to get better.

Honestly, to try to answer your question the best I can, we feel like it's a little bit of all the above. We feel like that everything from store operations, execution, service levels, continuing to work on our retention and turnover. You got to brag on our supply chain team, continued improvements with our product availability, our assortments and just really getting away from the COVID hangover, so to speak, when it comes to our supply chain. Brent and the entire supply chain team have done just an incredible job.

But generally speaking, I think it's a little bit of everything you mentioned. I think pretty broad-based from a customer standpoint, and we think it's probably fairly broad-based from where it could be potentially coming from a competitor aspect as well.

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

Okay. And I guess sort of a follow-up to that, now you're seeing -- there's such a big dispersion between execution on the distribution side. Are there any increased M&A opportunities, either large regional distributors that are private that you sort of see to maybe fill in some of that geographic white space you have out there around sort of between the Midwest and the Virginia DC.

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Yes. Sure. I'll -- Bret, I'll lead that off and then let Brent hit on kind of the first part of your question there. I'll just speak maybe to the M&A opportunities.

We're -- as you know, we're always looking for opportunities when it comes to greenfield expansion, but also strategic acquisitions that make a lot of sense from acquiring not only real estate and locations, but great teams of parts people that understand the professional side of the business and teaching those private companies how to be a dual market company. And so we're hopeful that maybe as things evolve the next year or 2, valuations and things like that can look a little more attractive than they have in the last couple of years, but still a little bit hard to say. But absolutely, we're always looking at the 1 store deals, the -- our job or customers that we still have that potentially don't have an exit plan, 1 store deals, 2 store deals all the way up to some of the regional things. And we're hopeful that as we continue to get more aggressive in the upper Mid-Atlantic and the true Northeast that some of our other opportunities come to life.

Brent G. Kirby - *O'Reilly Automotive, Inc. - Co-President*

Yes. And Bret, I would just add maybe on the distribution and supply chain side of things. Certainly, the exciting news about our Stafford facility that I talked about in my prepared comments, we're super excited about getting another large DC in the Mid-Atlantic. We see that as a big untapped geography for us and we're certainly investing to begin to take more advantage of that opportunity.

And when you think about our distribution infrastructure, for us, it's something we're constantly looking at. And talked about the strength of where our DCs are located and our DCs are where the cars are, where the people are. And we don't see that as an opportunity necessarily to use 3PLs or we want to own that. We want to run it. We want to operate it the way we always have, and we're always looking at hub store opportunities and how they augment the tiering of our DCs and where they are and how we can be first-in-class in every market that we operate in, in terms of parts availability.

So we're going to continue to do that. We certainly see that geography as a continued opportunity moving forward.

Operator

Your next question for today is coming from Daniel Imbro from Stephens.

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

Follow-up on Bret's question about market share. Just curious how the onboarding of the new customers progress. Any hiccups or learnings as you won some of the business so quickly? Any bottlenecks that are limiting growth in that kind of behind some of the infrastructure investment you guys are talking about?

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

Yes. Maybe I'll start there. This is Jeremy. And a little bit of interference on your sound. But I think the question really focused around what have we learned as we've seen the share accelerate within our business and how is that impacting how we move forward.

For sure, the increased volume that we're picking up, those are completely new customers that are unfamiliar to us in the markets that we're in. Every market we exist and we spend on the professional side of our business, a considerable amount of time understanding the market, understanding the shops, forming those relationships.

For us, the focus is always on how do we create value for those customers? How do we ensure that we're partnering with their businesses to help them be successful even as we go business. For sure is we've seen more and more opportunities to earn business over the course of really the last several years, during the course of pandemic, especially as we've seen the ability to grow on top of growth with those customers. Our touch points when we get that extra opportunity to provide outstanding service are just critical to being able to compound that growth. And I think as much as anything, what we've seen as we move through the last several quarters is our ability to provide excellent service to really demonstrate the value that Brad talked about earlier that we can provide excellent service, great informed technical people within our stores that understand the business, can support the work of our professional customers, incredible parts availability and just a broader support has provided an excellent value and continue to give us more and more opportunities.

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

That's helpful. And maybe I just wanted to dig into the SG&A spend a little bit more. Are there specific initiatives you can unpack around maybe what you're spending on, whether it's tech for your professional customers or delivery efficiency. Is there anything to help on that kind of clarify what you're spending on so we can better understand how it's driving sales?

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

Yes. I mean I think the general things that we've talked about are similar to how we've spoken to this item throughout the course of the year. And we're always, I guess, somewhat reluctant to get too far down in this. We think they're great investments for our company, and we just competitively, we want to see them play out for a long period of time. But for sure, we've made a concerted effort to continue to invest within our team. And we've talked about enhanced benefits, PTO and 401(k) improvements. And just more broadly, how we think about how our store managers manage their work week and things along those lines. We continue to invest in the image and appearance of our stores and our fleet vehicles, ensuring that get the safest vehicles on the road possible. And then technology continues to be a huge ongoing investment as we think about all areas of the business where we can bring better tools online to support the work that our store teams are doing and taking care of our customers.

Operator

Your next question for today is coming from Zach Fadem from Wells Fargo.

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

I think we're getting a lot of mixed data points on the state of the industry and putting your outperformance aside for a minute, curious to hear if you think the broader category is slowing or not? And to what extent the impact of a broader consumer slowdown would have on the aftermarket?

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Yes. Zach, it's Brad. I'll take a stab at that, and then I may flip it over to Brent to talk generally about what we're seeing and not seeing on some of those fronts.

But generally, speaking, Zach, we're just not seeing that. We -- as part of our results, as you can imagine, it's just hard for us to say that we're really seeing that. When I look at our positive DIY ticket count that I cited in our prepared comments, I mean, that's encouraging for us. We're very excited about the execution of our teams on the DIY side as well as the professional side. When I review the data that comes in every week from our sales team on the professional side, we have all our comments and sales call recaps that come through our CRM. That's not to say that within the service space that I see comments that some shops may be a little bit slower than other shops. But it's just hard for us to say with our results and what we hear and see on the street every day that there's an overall slowdown. We're just not seeing that.

Again, there's times you see that some shops may be seeing a little less car count than others. And just like on the service side -- or excuse me, just like on the aftermarket parts side of our industry, there's some service providers that are taking more share, and there could be some that are losing some share. So it's just hard to parse all that out and say that we're seeing an overall slowdown when we're really just not seeing that.

Brent G. Kirby - *O'Reilly Automotive, Inc. - Co-President*

Yes. Zach, I would add to -- I mean, just to echo Brad's comments, but it's really a tremendous testament to the culture and the execution of our teams out there. Our sales teams, our distribution center teams, I mean, they have just executed to an outstandingly high level and continue to. And not that we're immune for many of those things that may happen in the greater macroeconomic background, but we just have not seen the effect of that through the Q3 results, and we're not seeing it as we get into Q4 at this point. So we're going to continue to stay focused on executing, serving the need and meeting the demand out there. And we feel like good things will continue to follow.

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

The only I would add to that -- I'm sorry, just one more thing. I know you kind of talked to how do we think about that moving forward? I think from a long-term perspective, our view on the resiliency of our industry is unchanged. We've been through different cycles of challenges to the consumer in the past. And there is always a potential for short-term shocks and impacts and fluctuations that might last a quarter or 2. And we're always cautious on how we think about that near-term outlook. But the underlying core drivers of demand within the aftermarket continue to be resilient and strong. The value proposition that investing in your existing vehicle has for a consumer is very attractive. We think it continues to get more attractive with the vehicle dynamic and people are still using their cars for so much of what encompasses daily life with miles driven, steadily expected to increase.

So those things are all, I think, positive as we think about really the longer term, and that's really where our focus is as we think about building our business.

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

Okay. Great. That's great color. And with respect to competition, it seems like the WDs had been operating with one hand tied behind their back in the early days post the pandemic. But with those businesses now back in stock and ready to recapture some of the share that they lost, do you think we could be entering a period of choppier pricing, particularly as we lap the double-digit inflation in the industry?

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Yes, Zach, it's Brad. Well, the first thing I would say is, I know we all in the industry anecdotally, felt like potentially some of the smaller players could have had a little bit more adversity when it came to supply during the pandemic. And I think that was probably true and I think it's probably accurate for the most part, looking across the market that they're probably healthier than ever. I think the key with that, though, is that we had our opportunities too. We -- Brent and I and none of us were totally happy with how we performed during the pandemic, everything from merchandising to inventory control, purchasing down to distribution operations. Our bar at O'Reilly, knowing how important availability and replenishment is high. And so we weren't totally happy with where we were and we've made incremental improvement as well.

But I think the key to remember, Zach, on when we had opportunities to pick up share and we were able to maybe move from third call to second or we got the opportunity through lack of supply from somebody else, and we were able to step in there with relationships, service and back that up with availability, that business, as you know, Zach, especially on the professional side is incredibly sticky. Those relationships and that trust, it takes time to build that and to gain that business. It takes a long time to gain that business and it would be challenging -- or excuse me, it would be it would be out of the norm to lose that business very quickly when you've really stepped in when somebody else fell down. And so I think we just got to remember that that business is very sticky. The relationships are sticky. And once that's built, it's very stable.

On the pricing, no, we just -- we don't feel that way. We're not seeing that, and we really don't see that as an issue moving forward. I mean, time will tell, but -- as you know, Zach, when we rolled out our pro pricing initiative, for example, that was very rifled approach, strategically geared toward some of the lines that maybe some of the WDs and 2 steppers were more aggressive than we were, and we purposely moved down and still stayed north of where a lot of those price points were. We didn't come down to really compete, knowing that they can move further down. And a lot of those folks live out volume anyway. And so we just don't see that as a near-term threat.

Brent G. Kirby - *O'Reilly Automotive, Inc. - Co-President*

And Zach, maybe -- just maybe to add a couple of comments to what Brad has already said on the pricing, especially from a WD perspective. If you think about what we -- some of the things we did do to get stronger through some of the challenges that COVID that Brad talked about, we've continued to diversify our supply chain across more multiple suppliers for various lines, especially in our proprietary brands. We continue to see our proprietary brands grow. So we -- and we continue to be pleased with what that is yielding in terms of our gross margins and how we're able to continue to enhance those moving forward. I feel like we're in a much better strategic position probably than where we were going into COVID. If there is something irrational that does come up out there, but we're just not seeing it at this point.

Operator

Your next question for today is coming from Simeon Gutman from Morgan Stanley.

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

First question is on gross margin. It step back a bit from price investments and we've come to accept that it probably won't snap back anytime soon. Anything new on that as you get leverage over some of the distribution costs? Are you reinvesting those? Is there any reason we can see gross margin click back up?

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

Yes. Simeon, it's Jeremy. We continue to focus on gross profit dollar growth. So obviously, in a few months here, we'll speak to where we think '24 might look. But at this stage, in our hope, I think from a longer-term perspective, as we think about our gross margins, really kind of comes to what we can do incrementally to improve the unit volume out of our stores, which helps us leverage DC expenses. I think that, obviously, during the course of the pandemic was pressured as the supply chains got more challenging and feel like that we've got an opportunity from a more normalized standpoint to do a bit better there as we take market share.

Certainly, I think the value that we have as a partner to our suppliers to be an excellent way for them to grow their business and to -- and to gain market share themselves is high. It continues to be, I think, a favored -- kind of a favored nation status for us. And obviously, that's important for us as we work to manage our costs over the course of time. And I think what we've seen during the course of some of our positives this year have been the ability to do incrementally better on the acquisition cost perspective. But our focus has always been how do we partner well with the supplier base and our communities, how do we improve availability so that we can drive topline sales growth and then gross profit dollars that flow from there.

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

And then a quick follow-up. This is to clarify some of the points, Jeremy, you made -- I think, Brad made around market share. Is the story of the incredible market share of this year, is that -- you said more new accounts that you had in service before or is being a primary distributor meeting #1 on the call is that market share penetration, it keeps ticking higher?

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

Yes. Thanks for that question, Simeon. I wouldn't want there to be any confusion there. It's a little bit hard for us to really classify a new account versus non-new account. Our store teams are -- I mean, they -- they're relentless in understanding every dollar business that's done in a market. We will -- especially as you think about going into a new market, we're going to canvass that market, and we're going to take around our credit app, so we're going to want to sign up everybody to be an O'Reilly customer from day 1. So the concept of completely new customers is a little bit foreign for us. It's really how do you continue to grow a larger share of that wallet. And I think what we've seen, just broad-based over the strong momentum we've had is that we've been able to grow share on both our larger accounts that were heavy purchasers of O'Reilly Parts and maybe we already have farcical status all the way down what the culture would have looked like.

So it's pretty broad-based for us. I don't know if there's any one type of customer group that we think is outside that moves the needle versus the broader population.

Operator

Your next question for today is coming from Greg Melich with Evercore ISI.

Michael David Montani - *Evercore ISI Institutional Equities, Research Division - MD*

It's Mike Montani on for Greg. I wanted to ask, first off, if I could, about the impact of inflation in the quarter. Can you just give us a sense of the level there? And then do you see inflation just basically turning into more disinflation in the fourth quarter? Or should we be thinking about the potential for outright deflation to come in?

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

Yes, Mike, thanks for the question. Third quarter was kind of low single digits, that's kind of continued to ratchet down this year completely in line with what we expect. We don't, by any means, anticipate deflation within our business. We think our industry over the long term has been able to hold the price levels. It's -- there's a lot of inventory investment. It's a nondiscretionary spend for certain -- even as some of us realize some cost improvements, we've been able to hold on our prices, and that's what we would anticipate seeing moving forward. We've really sort of -- as we've exited third quarter and we think about fourth quarter, we would really say, and Brad said in his comments, a normalized inflation environment.

We'll have a little bit of it. It's going to be in that low single digits, not a huge tailwind, but really more consistent with what we've historically seen within the business.

With the opportunity from an added benefit perspective that as parts become more complex and the new applications are -- have better technology, they're engineered better, the complexity is going to drive the overall value of the changing dynamic of parts to cause average tickets to go up. And then it's our challenge to continue to grow those tickets just on how we provide great service to our customers.

Michael David Montani - *Evercore ISI Institutional Equities, Research Division - MD*

And just from a gross margin comparison, I just wanted to ask anything to know from a LIFO perspective as we head into the fourth quarter and/or any impact from that in the third quarter?

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

No, really. As we think about our -- how we report and think about our gross margin, we view our reported gross margin is the best measurement of how we think about the business, most current reflection of what we're paying for parts today and don't really, I think, internally or externally view some of the changes in the nominal LIFO reserves on our balance sheet to be as relevant for us is what we think the topline reported margin is in and we continue to expect that to be stable as we've maintained our guidance really all year long on that item.

Operator

Your next question is coming from Chris Horvers from JPMorgan.

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

Best of luck, and congratulations, Greg. My first question is trying to dial in a little bit more on the SG&A. I guess can you talk -- help us think about how much of the SG&A is just naturally more of that variable relative to other retail models, given how you incentivize and reward your employees. So like if comps were up 3% to 5% and we backed out the PTO adjustment, but then you ended up doing [NA], how would you think about that normalized SG&A per store growth of 2% to 2.5%. What would that go to holding everything else constant?

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

Yes. Thanks, Chris. Appreciate the question. And there are, I think, a lot of moving pieces in that, especially in a year like this year when we've done some things that are outside of our normal cadence of spend as it relates to the investments that we've made. We still continue to operate a relatively high fixed cost model just because of the nature of having so many units in the store teams that are there. So that does benefit us as we grow sales and be reluctant, I think a little bit to quantify or try to parse out those individual numbers. But I think there is a positive.

Certainly, in a year like this when we really seen such an acceleration in growth, there is just a level of activity that that requires, and that's a lot of what we saw here in the third quarter. Part of that is incentive comp, but part of it is, especially on the professional side of the business, we don't want to ever be in a spot where we can't get parts out to our shops really quickly and manage that business. So it is a little bit of a mix between the two. And I think in kind of a little bit more of a normalized sales environment, we expect that we'd be in a pretty stable place. But for sure, our approach this year has been -- as we have gained the momentum that we have, the opportunity to accelerate that growth by investing in the business has been a key priority for us.

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

Understood. And if we went back at 10 to 15 years ago, there was always this view that -- there was a view that you actually originally agreed with that like private label parts aren't going to work for certain type of cars, whether it's a foreign nameplates, certain mechanics didn't like private label and there was this push to have access to OEM parts, particularly on the foreign nameplate side. Do you think the industry has changed in any way where there is -- the customer's more -- the mechanic's more amenable? And how has your capabilities around that changed over time?

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

Chris, this is Brad. That's a great question, and I'll take a stab at it and then maybe flip it to Brent for any other commentary on private label. And I think your -- overall, I think it's accurate, what you said. This is my 27th year with the company. When you think back to the early 2000s and you think about the 90s, just in my experience back then, there was less quality in some cases going into private label boxes back then. And we sold against that for a long, long time with a lot of success with more of the national brands and the national company, so to speak. But really, is really the last couple of decades have evolved, the quality that goes into our exclusive national brands is unbelievable. A lot of those same parts not only meet OE quality fit, form and function, but they exceed. And so you think about the success we've had with import direct specifically to what you're talking about with the European nameplates along with the Asian, I mean we couldn't have more confidence in the quality, fit, form and function that's going into that OE box. And it is, again, not only OE, it's -- in a lot of cases, it's better than OE. And so I do think that that dynamic has changed some over the decades. And so we have a lot of confidence in what's going into our exclusive national brand box and we feel really good.

We have a lot of opportunity to continue to get better at gaining share in the specifically European shops. We have a lot of tremendous competitors out there that have been really great at that for a long time, but we feel really good about all those things.

So, Brent, any other thoughts on the private label?

Brent G. Kirby - *O'Reilly Automotive, Inc. - Co-President*

Yes. I think maybe just a couple of other thoughts on private label, what we've seen. Brad called out the success of our proprietary brand, import direct. But as we continue to build more quality and spec in the box, we just continue to see more adoption and uptake for those. We launched -- we have our BrakeBest break line. We've got good, better, best. We've got full line designs in our proprietary brands now. We launched BrakeBest Select Pro earlier this year. We're seeing tremendous both uptake on both the DIY and the professional side. Again, customers are looking for quality and they're looking for something that's going to meet their need at the time of need.

So we've talked a little bit about proprietary brand penetration now being over 50% of our revenue. We continue to see that number grow. We continue to see strong adoption of those proprietary brands, both with our DIY and professional customers. So we'll continue to lean into that strategy, and we'll also continue to have a national brand as part of our line design and where we think it has relevancy in that particular category.

Operator

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

Brad W. Beckham - *O'Reilly Automotive, Inc. - Co-President*

This is Brad. Thank you, Holly. We would like to conclude our call today by thanking the entire O'Reilly team for your unwavering dedication and the great results you have generated throughout 2023. I would like to thank everyone for joining our call today, and we look forward to reporting our fourth quarter and full year results in February. Thank you.

Operator

Thank you. This does conclude today's conference call. You may disconnect your phone lines at this time, and have a wonderful day. Thank you for your participation.