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Q3 2024 O'REILLY AUTOMOTIVE INC EARNINGS CALL

EVENT DATE/TIME: October 24, 2024 / 3:00PM UTC

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- **Operator**
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PRESENTATION

Operator

Good day, and welcome to the O'Reilly Automotive, Incorporated third-quarter 2024 earnings call. My name is Ali, 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 Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Thank you, Ali. Good morning, everyone, and thank you for joining us. During today's conference call, we will discuss our third quarter 2024 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, guidance, target 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, 2023, and other recent SEC filings. The company assumes no obligation to update any forward-looking statements made during this call.

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At this time, I would like to introduce Brad Beckham.

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

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 Brent Kirby, our President; and 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 would like to begin our call today by thanking our over 92,000 dedicated team members across North America for their incredible commitment to our customers during challenging conditions. Our teams continued to deliver positive comparable store sales results and market share gains, which I will discuss in more detail in a moment.

I'd first like to highlight the tremendous resolve our team showed as they persevered through major weather events since our last call. Hurricane Helene at the end of our quarter in September and Milton following shortly after our quarter end in October, along with substantial flooding in North Carolina, created some very trying circumstances for our teams, our customers and our communities.

These events impact not only in the direct path of the storms, but also multiple teams across our store, distribution and support network who actively prepare for the storms and navigate the recovery.

Our business is built on people and relationships and our relentless commitment to providing excellent customer service to our customers is more critical than ever in a time of need. Our thoughts and prayers continue to be with the individuals and communities facing significant challenges in the aftermath of these storms. I'm still very proud of the continued dedication of Team O'Reilly to our customers and we stand ready to do our part as these communities rebuild.

As we noted in our press release yesterday, our third quarter comparable store sales increased 1.5% and stacked on top of impressive 8.7% and 7.6% third quarter increases in 2023 and 2022, respectively. As impressive as our multiyear sales growth has been our sales results for the third quarter of 2024 were below expectations in our high-performance standards.

We had a solid start to the quarter in July. However, sales softened at the end of the month and these trends continue throughout much of August and September. As a result, the cadence of our sales performance relative to our expectations was fairly consistent during the third quarter with our team driving positive comp growth each month.

We attribute the sales softness to a challenging industry demand backdrop I'll discuss in a moment, and view the weather impact in the quarter as neutral with the exception of the final week in September where we saw a modest headwind from Hurricane Helene.

Overall, our comparable store sales growth continues to be driven by the strength in our professional business, where our team delivered another quarter of mid-single-digit comps.

Consistent with the first half of the year, the majority of our professional sales growth is being driven by growth in ticket counts. Our team is continuing to generate these share gains on top of mid-teens professional comps in the prior year.

In an industry built on service, availability and strong customer relationships, our ability to not only defend the share we have taken, but also to capture incremental business is concrete evidence of the incredible consistency and execution of our team.

We are pleased with the sustained momentum we've been able to create in our professional business and see a long road of opportunity ahead of us in what remains a highly fragmented market.

Our professional comps continued to be partially offset by pressure to DIY comparable store sales, which were down approximately 1% in the quarter due to negative ticket count comps. Average ticket values were positive on both sides of our business and included a benefit from same SKU inflation of approximately 1%.

On a category basis, we remain encouraged by solid performance within maintenance categories such as oil, filters and spark plugs. We also continue to see customers prioritizing the better and best level products on the value spectrum, with as many customers trading up on a spectrum as those trading down to entry-level products. Both of these dynamics reflect strong support of the value proposition for our consumers of maintaining and investing in an existing vehicle.

The softness we are experiencing continues to be more pronounced in our discretionary categories such as appearance chemicals, accessories, tools and performance parts. As we've noted in the past, these categories did not comprise a significant portion of our business and typically are not primary drivers of comparable store sales performance.

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That said, this is an area where consumers can pull back when being more cautious with their spend that, in turn, create some volatility during pressure times. We are also seeing a trend of softness across some repair categories impacted by cumulative wear and tear on vehicles.

We firmly believe that our experienced store teams of professional parts people supported by our robust tiered distribution network, offer the best combination of service and availability in the industry. We remain confident in our ability to outperform the market within these repair categories as conditions improve.

While we are relentless in pursuing every opportunity to improve our service levels and capture incremental business, we view the results we are experiencing now as indicative of broader pressure across the industry. We believe current industry headwinds will be short-lived and remain confident in the long-term fundamental drivers of demand, supported by the value proposition of investment in the repair and maintenance of existing vehicles.

Having experienced these cycles many times within our industry, we have confidence that the pressure we are experiencing today is not reflective of any change in the core domain drivers in the automotive aftermarket.

The North American Car Parc continues to grow and age and consumers place a heavy reliance on well-maintained vehicle to meet their daily transportation needs. In our view, the average consumer is still reasonably healthy, but we believe is exhibiting an element of caution when managing their pocket book in an environment of uncertainty surrounding price levels, macroeconomic conditions in an upcoming election.

Caution is demonstrated by consumers is more impactful in our DIY business as these consumers tend to be more economically pressured and [perform] on their vehicles out of necessity. Our DIY customer base continues to represent slightly over 50% of our business. Even with the non-discretionary nature of most of the products we sell, we are not completely insulated from a consumer who is motivated to limit spending wherever possible.

However, consumers in our industry are very resilient and eventually adjust to adverse economic circumstances and will prioritize keeping their vehicle in good working condition. This is especially true as our customer base is incentivized to keep their existing vehicles on the road at higher mileages in order to avoid the cost of replacement vehicle.

While we are cautious that the current macro pressures could persist as we finish out 2024 and enter next year, we are confident our industry will return to more historical growth rates in the short term. Against this backdrop, we are tightening our full year comparable store sales guidance and are now expecting a full year increase of 2% to 3%. This update reflects our third quarter performance and how we're viewing the remainder of the year.

As a reminder, our fourth quarter can be quite volatile given the variability of winter weather and consumer demand dynamics during the holiday season as well as potential impacts this year from the November election. We do expect a benefit in the fourth quarter as we lap our easiest comparisons of the year and have 1 less Sunday in our quarter.

So far, our October sales performance has been consistent with our third quarter trends and in line with our updated guidance expectations.

It's important for me to note that the update to our outlook has absolutely no impact on the attitude and aggressiveness of our field teams as they demonstrate as they go to the market on a daily basis. No one inside our company thinks our high bar performance and the standards we have set are impacted at all by conditions outside of our company nor do we change the amount of hustle we demand of ourselves each and every day.

We are very bullish on the future of our industry but more importantly, the tremendous opportunity our company has to grow our share of both the DIY and professional markets. We will continue to execute the playbook that has driven success for our company for 67 years, and are more committed than ever to providing the best possible customer service in every one of our markets.

As I wrap up my prepared comments, I'd like to once again thank Team O'Reilly for your commitment to our customers, our company and to your fellow team members.

Now I'll turn the call over to Brent.

Brent Kirby *O'Reilly Automotive Inc - President*

Thanks, Brad. I would also like to begin by thanking Team O'Reilly for their commitment to excellent customer service and focus on perpetuating our culture. Our team's ability to drive share gains in a challenging environment demonstrates both their outstanding

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professionalism as well as the value our customers place on excellent service and product availability.

Today, I will give some color on our third quarter gross margin and SG&A results as well as our progress on expansion and capital investments. Starting with gross margin. Our third quarter gross margin of 51.6%, was up 18 basis points from the third quarter of 2023, and in line with our expectations.

Dilution from our Canadian business came in as expected at approximately 26 basis points on the quarter. We continue to expect approximately 30 basis points of gross margin dilution from the acquisition along with 15 basis points of operating profit dilution for full year 2024.

Our gross margin results included a headwind from the mix of DIY and professional business, which was slightly larger than anticipated as the sales pressures we experienced were more significantly felt in our higher-margin DIY business.

However, we were able to offset this headwind with strong merchandise margin performance achieved through a combination of both improved acquisition costs and strong partnerships with our supplier base to manage our product offerings, including our proprietary private label brands.

We would still characterize the acquisition cost environment as stable and would anticipate seeing a mix of both incremental cost improvements and modest inflation pressure as we finish out 2024. These cost dynamics are coupled with a pricing environment that remains rational across our industry.

Given our solid performance in the first nine months of 2024, we are maintaining our gross margin outlook for the full year at a range of 51% to 51.5%.

Moving on to SG&A. Our average SG&A per store grew 4.2% in the third quarter. With the inclusion of Canada's operating results, again, representing approximately 10 basis points of that growth. Our SG&A dollar spend for the third quarter was at the high end of our expectations and drove a higher level of deleverage on the sales headwinds that we experienced.

Our teams in the field continue to effectively balance excellent customer service with dialing in our staffing levels to match business conditions and took appropriate steps to manage expenses as we saw incremental pressure to sales in the third quarter.

However, our SG&A flexibility was limited somewhat by pressure that we saw in self-insurance cost for our retained exposure for vehicle liability and property losses, driven in part due to Hurricane Helene as well as a headwind from deferred compensation.

Based on our year-to-date results in 2024 and updated outlook for the remainder of the year, we continue to expect full year SG&A per store to grow between 3.5% to 4%. This guidance range includes our expectation that our fourth quarter average SG&A per store growth will be at the lowest of the year, primarily resulting from a more fully loaded comparison in the prior year.

As we have managed our SG&A spend in 2024, our focus has been guided by an expectation that our high level of customer service will drive robust sales growth over the long term. The adjustments that we make to our SG&A spend are deliberate and measured and we do not overreact to make dramatic adjustments that would negatively impact our customer service levels and long-term growth opportunities.

Factoring in our year-to-date performance and our outlook for the remainder of the year, we are updating our operating margin guidance, and now expect the full year to come in within a range of 19.4% to 19.9%. The reduction from our previous guidance is driven by our third quarter sales performance and updated full year comparable store sales expectations.

Next, I would like to provide an update on our inventory, capital expenditures and expansion results. Inventory per store finished the quarter at $781,000, which was up 3% from both this time last year and the end of 2023. We continue to be pleased with the health of our supply chain and our store in-stock position remains strong.

We are leaving unchanged our 2024 target of 4% growth in inventory per store within our existing chain, excluding the impact of the acquired Vast-Auto inventory. Our teams have been opportunistically deploying inventory throughout the year to supplement our store, hub and DC level inventories, ensuring that we are offering the best inventory availability in all of our markets.

We opened a total of 47 stores during the third quarter, bringing our year-to-date store openings to a total of 111. We are slightly behind our new store growth plan as we have had some third quarter stores pushed back due to delays in construction and final permitting. However, we remain on track to open 190 200 new stores in 2024, and our new store performance continues to exceed our expectations, even in tough market conditions.

I am also pleased to announce our 2025 store opening target of 200 to 210 net new stores. New store growth continues to be an attractive use of capital for our company. Our disciplined approach to greenfield new store growth and our resulting success in

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generating high returns on new store locations is centered around 1 primary determining factor. The quality of the store team behind the counter, the day we open the doors.

We work hard to support our new store teams by executing a rigorous playbook to select great sites, informed by local market characteristics, vehicle population and professional customer concentrations. We also ensure each location has our industry-leading inventory availability right out of the gate.

Ultimately, though, our success is all about assembling the right team to go out and win the business, both inside the four walls of the store and in supporting roles in regional sales and field leadership. Perpetuating our culture through a promote from within philosophy ensures that we have engaged leadership teams with proven success in executing our store operating model.

Moving on. Our capital expenditures for the first nine months of 2024 were $733 million, which is in line with our expectations. And we are maintaining our full year guidance range of $900 million to $1 billion. Our projects and initiatives continue to track as planned and we are excited about the growth opportunities ahead of us in all of our market areas.

I would like to extend congratulations to our distribution operations teams on the successful opening of our new Springfield distribution center in September, and we look forward to a successful opening of our new Atlanta Metro DC in the fourth quarter.

It is exciting to see the growth in our distribution network with the relocation of these 2 facilities opening this year as well as the continued progress on our new Mid-Atlantic DC in Stafford, Virginia, which will open in 2025. I want to express my deep gratitude for the hard work from all of the teams involved in the successful expansion of our industry-leading distribution network.

To close my comments, I want to once again thank Team O'Reilly for their continued dedication to our customers. Our team recognizes that our success is dependent upon providing the best customer service in our industry, and I'm excited about the opportunities ahead of us.

Now I will turn the call over to Jeremy.

Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Thanks, Brent. I would also like to thank Team O'Reilly for their hard work during the quarter. Now we will cover some additional details on our third quarter results and outlook for the remainder of 2024.

For the quarter, sales increased $161 million, driven by a 1.5% increase in comparable store sales and a $66 million noncomp contribution from stores opened in 2023 and 2024 that have not yet entered the comp base. For 2024, we now expect our total revenues to be between $16.6 billion and $16.8 billion.

Our third quarter effective tax rate was 21.5% of pretax income, comprised of a base rate of 23%, reduced by a 1.5% benefit for share-based compensation. This compares to the third quarter of 2023 rate of 23.2% of pretax income, which was comprised of a base tax rate of 24.3%, reduced by a 1.1% benefit for share-based compensation.

The reduction in our base rate was driven by the size and timing of recognition of benefits for certain tax credits. For the full year of 2024, we expect an effective tax rate of 21.8% comprised of a base rate of 23% reduced by a benefit of 1.2% for share-based compensation.

We expect the fourth quarter rate to be lower than the other three quarters due to the totaling of certain tax periods. Also, variations in the tax benefit from share-based compensation can create fluctuations in our quarterly tax rate.

Diluted EPS for the quarter increased 6%, with our year-to-date diluted EPS increase at 7%. We have updated our EPS guidance range to a range of $40.60 to $41.10. The $0.15 reduction to our range is driven by our third quarter sales results and our revised sales outlook for the remainder of the year. As a reminder, our EPS guidance includes the impact of shares repurchased through this call, but does not include any additional share repurchases.

Now we will move on to free cash flow and the components that drove our results. Year-to-date, free cash flow for the first 9 months of 2024 was $1.7 billion, in line with the same period in 2023, with growth in income, partially offsetting the expected headwind from cash taxes paid resulting from the timing of payment for renewable energy tax credits.

For 2024, our expected free cash flow guidance remains unchanged at a range of $1.8 billion to $2.1 billion. Our AP as a percentage of inventory finished the third quarter at 129%, down from 131% at the end of 2023. This ratio was slightly above our expectations driven by the timing of inventory investments throughout the year.

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We continue to expect to see moderation in our AP percentage through the end of 2024 and expect to finish the year at a ratio of approximately 127%.

Moving on to debt. We successfully issued $500 million of 10-year senior notes in August. We finished the third quarter with an adjusted debt-to-EBITDA ratio of 1.96 times as compared to our end of 2023 ratio of 2.03 times, with a decrease driven by EBITDA growth. We continue to be below our leverage target of 2.5 times, 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 499,000 shares at an average share price of $1,084 for a total investment of $541 million. Year-to-date through our press release yesterday, we repurchased 1.6 million shares at an average share price of $1,043 for a total investment of $1.7 billion.

We remain very confident that the average repurchase price is supported by the expected discounted future cash flows of our business, and we continue to view our buyback program as an effective means of returning excess capital to our shareholders.

Before I open up our call to your questions, I would like to thank the entire O'Reilly team for their dedication to our company and our customers. Your hard work and commitment to excellent customer service will continue to drive our future success.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Bret Jordan with Jefferies.

Bret Jordan *Jefferies - Analyst*

A question on supply chain. With the Virginia DC opening, and obviously, you've got one in Devens, Mass, do those two allow you to touch into that metro sort of mid-Atlantic Northeast New York market? Or is there some additional supply chain expansion needed before you get to that white space in the Northeast?

Brent Kirby *O'Reilly Automotive Inc - President*

Yes. Bret, thanks. This is Brent. I'll start and these guys can join in. Thanks for the question. Yes, we're super excited about that Mid -Atlantic DC. As you know, that opens up a corridor there of the Mid-Atlantic that we've just have a lot of opportunities to continue to store up.

And so we feel like it's going to really pave the way for us to open up that corridor. To your point, when we think about the distance between Stafford and Devens, they'll likely probably will, at some point, be another one that would be a fill in there. But super excited to get started on having that capability in that location.

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Yes. Bret, this is Brad. I may just jump in real quick. Brent said it pretty well. But I think the way I think about it, we still have such an opportunity in Northeast part of the country, depending on where you draw the lines, you could come up with one-third of the population in the US. So we're extremely excited. Still have a lot of opportunity in New England.

And then when you get into Northern Virginia, the DC Metro, Baltimore, Philly, those type markets, I think the way I would see it is that we're going to expand from the inside out from that Virginia, DC. We're going to concentrate kind of right in those metros and not try to stretch ourselves too far out too quick in between those two DCs.

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Those are extremely competitive markets, a lot of store opportunity, a ton of DIFM opportunity, a lot of retail opportunity but we'll work those rings from a site acquisition standpoint in very tight bands of that Stafford facility.

Bret Jordan *Jefferies - Analyst*

Okay. Great. And then a big picture question on hurricane impact. I mean, you sort of think about the net impact, obviously, store closures and short-term sales losses, but is demand creation from hurricanes enough to offset that? Are they, at the end of the day, a positive or a negative for sales volumes?

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Yes. Good question, Bret. Well, first and foremost, I have to say, like I mentioned earlier, that we couldn't be more proud of our teams. It's just been devastating to watch what's happened.

We were fairly fortunate in the Florida market here of late, but had quite a bit of disruption with Helene, specifically in South Georgia and then up in Western North Carolina. And we obviously -- especially in that last week, there Helene hit, we saw some disruption.

But I think what we would say, Bret, we're a little bit careful with us being disappointed with our comp overall. We wanted to be a little bit careful talking about too many puts and takes. We're not happy with a 1.5% comp. But if we had to put a number on it, it would end pretty immaterial.

It would have been possibly in the 10 to 15 basis points maybe in the quarter in terms of Helene. And then overall in the fourth quarter, it's yet to be seen kind of what will make up there. But I think when you look at third and fourth quarter, even with those bad storms, I think I think weather is a net neutral.

Operator

Simeon Gutman , Morgan Stanley.

Simeon Gutman *Morgan Stanley - Analyst*

I want to ask, you made the comment about headwinds should be short-lived, and I think that makes sense. If you look at the industry, the industry got weak, almost maybe a year, three quarters before your business got a little softer.

So why does it flip soon? What about -- what confidence do you have? Is there anything about like a micro basis on failure rates? Or are there any markets that you have where you've had some softening and then a restrengthening that you can point to? Like help us think about timing? I know there's no crystal ball, but it's a tricky setup.

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Yes. Great question, Simeon, and I'll try to do the best I can here. So I think generally, when you look back at we don't want to live in pandemic times. And we obviously saw a lot of success there. So we've built our base definitely several step changes there and on both sides of the business, obviously, more predominantly on the professional side.

But when we think about a year like this. And again, we've said this a lot, you've heard us say it a lot, but in my 28 years in the industry and with O'Reilly, we've just lived this so many times that while we're not happy with our 1.5% comp and really our year-to-date comp.

The reason that I called out short-lived earlier is just because when we lived this in an election year in times of higher inflation and all the things that have been on the consumer this year, which is the uncertainty.

Once we get past the election and you think about how the inflation has moderated. And a lot of things are piling up to the fact that we feel, even though we're not guiding to '25, obviously, yet, we do feel confident that history repeats itself in our industry, and we continue to feel good that we're going to get past this here soon and get back to kind of normal industry growth.

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Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

And maybe, Simeon, the only thing I would add there, specifically, are we seeing anything in any granular way that's pointing us to that, at this point we would say no to that question. I want to be clear about that. Given a 1.5% comp in the third quarter, we are at where we're at. The confidence that we have is what Brad talked about.

I think, though, importantly, one of the things that you identified is just as a company, our focus has always been how do we best manage through these periods to put ourselves in the best position possible as conditions start to improve to be able to be the first to capitalize and take advantage of that.

We always want to be in a situation where it doesn't seem like we're participating in the industry slowness until it's persisted for a while and we want to be the first ones to come out of. And I think our teams have demonstrated the ability to do that over the course of time from a consistency perspective.

And so I think that, coupled with what Brad said about what we've seen from an industry perspective over the long term gives us confidence that we're going to be well positioned to move forward from this point.

Simeon Gutman *Morgan Stanley - Analyst*

Makes sense. And then a quick follow-up, a question on market share. Two years ago, the spread O'Reilly to industry was significant, it blew out. This year, you're still taking share. It looks like it's narrowed a little. When you -- as you approach how you forecast next year, first, do you always put a market share component into your own comp expectation? And then how do you figure where that lands? Is it a normal year? Just what are the puts and takes? .

Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Excellent question, Simeon, and one that we'll spend a fair amount of time on between now and next quarter when we provide our guidance for next year. For sure, our expectation is that because of the team that we have, our advantage is, from a distribution availability perspective and the momentum we've created that we think it is, it is our entitlement to grow faster than the market.

So for sure, you should have an expectation that as we finalize that work into next quarter, what our expectations are for 2025, that include a component of that consistent with where we've been really for much of our history.

Operator

Michael Lasser with UBS.

Michael Lasser *UBS Investment Bank - Analyst*

This has been a year where uncharacteristically O'Reilly has just misgauged the demand in the market and has had to guide down a couple of times. Now it's -- we're only going to be a few months away from how you're starting to think about 2025.

If we go through the next few months, let's say, it's a normal season from a weather perspective and you don't see your trends improve, would you still be coming out at the outset of the year with a normal O'Reilly algorithm in the 3% to 5% comp range.

And the second part of that question is if the industry is going to have another sluggish year next year, what does O'Reilly think the right level to comp is in order to generate sustained margin expansion on the expense side?

Put another way, how low can comp be next year without having some deleverage will you see your SG&A per store still grow 2% to 3% or higher if indeed, trends remain sluggish next year?

Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

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Yes, Michael, thanks for the question. This is Jeremy. I think you're accurate in saying that the year like we're having this year is uncharacteristic, I think, for us, for our history. Although -- though it's not completely unprecedented. We've had years like this, our industries has had years like this.

I think for us, having a near-term focus to try to predict exactly the sequence and timing of exactly how the business performs and moves out of it. It is one that we've got some insight into, but frankly, we don't have the same. We don't have a crystal ball that all of you don't have. And we'll have to evaluate what our best read is when we establish our guidance for 2025.

So it's a challenge to answer that from a hypothetical situation because we do still have I think some pretty relevant time period between now and how we form kind of from a concrete perspective, what those opinions are.

I think that same answer applies to how we think about expense structure and what our read is on what overall cost levels are going to be next year and how we think the components of what our 2025 guide will be comprised, what benefit we might think we see in same SKU inflation in those things.

I think maybe to step back from near-term questions that try to pull forward our guidance setting process for next year and to just talk, I think, structurally on how we feel like we can operate our business and the profitability of our business. We still believe that we are positioned well to take share gains to be productive in doing so and provide strong returns for how we're investing in the business.

And so I think as we put together those expectations for 2025, you'll see similar conviction around the success of our business that we've had underlying our results for a long time.

Michael Lasser *UBS Investment Bank - Analyst*

Okay. My follow-up question is how much work are you doing today to prepare for the prospect of tariffs in the next couple of months? And how disruptive would be 30% to 60% tariff on goods coming from China and some degree of tariff coming in -- goods coming from all other countries.

Brent Kirby *O'Reilly Automotive Inc - President*

Yes. Michael, this is Brent. Great question. I can start and these guys can add in. Most recent point of reference we have on any kind of scenario like that would be back in 2018 when we had the tariffs 2017, 2018, before.

Honestly, we were able to pass those increased costs through in selling price. And really, that wasn't just us. That was the entire industry, so it was kind of a nonevent in terms of some of those components.

What I will tell you, since then and since COVID and through COVID, our teams, our supply chain teams, sourcing teams, merchandise teams have done a fantastic job continuing to look at alternate supply sources, countries of origin, we continue to leverage the strength of our proprietary brand portfolio to source from multiple suppliers.

So I would tell you that we are less dependent on anything from China than we were, not to say that we still don't have some dependencies there we do and our industry does. But really proud of the work the team has done over the last several years to reduce that dependency.

But where that does come into play, specifically with China, I still feel confident in our ability to pass those costs along where they may become a part of cost of goods.

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Yes, Michael, the only thing I would add to reiterate, to Brent's point, is our supply chain teams, our merchandise team, they put a solid playbook in place back to the years that Brent talked about, and they will be what they'll be, and it will somewhat be a level playing field for us and our competitors and everybody else we can compete against out there.

And I feel really good that our team has the strategy in place to pass those along and do all the things that Brent talked about. So we feel good that we'll be able to handle that if it comes.

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Operator

Zack Fadem , Wells Fargo.

Zach Fadem *Wells Fargo Securities - Analyst*

This has been asked a couple of different ways, but taking a different angle here. Just curious as you look back over the course of the year, if you can pinpoint when specifically the deferred maintenance dynamic started to materialize in your data.

And as you look to Q4 and beyond, any thoughts on what the drivers historically tend to be that unlock or catch up pent-up demand, be it lower gas prices, which we're starting to see today or weather. Any thoughts there?

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Yes. Thanks, Zack. This is Brad. I'll kick that off and then let the other guys kind of clean me up here. But first off, I think if you think back to the last couple of quarters, for a long time there, even though we were seeing some pressure in discretionary going back a quarter or two ago.

You mentioned maintenance. We actually are very pleased with our maintenance categories. We look at it more from the biggest part of our business is nondiscretionary failure, repair type jobs. Some of that stuff can still be a little bit delayed. We're fairly pleased with our failure and kind of repair categories.

Maintenance has been really good. I called that out in my prepared comments, things like oil changes, oil filters, oil, spark plugs, things like that, maintenance. We haven't seen a lot of deferral. Now there could be some deferral in there and other parts of it could be later model vehicles that are somewhat offsetting that. There's a lot of moving pieces.

Really, what we continue to see, but what we saw more pronounced in Q3 than we have year-to-date would have been even more so discretionary and then we saw a little bit more trade down. You've heard us talk a lot about actual trade up from good to better and better to best. We did see some offset in that in Q3, while we still saw customers trading from better to best. We did see some that we're moving down to some extent there in Q3. So that's kind of what I'd say and may let Brent.

Brent Kirby *O'Reilly Automotive Inc - President*

Yes. The other thing I would say, Zack, great question. I mean the trend has -- everything Brad just described has kind of been a theme that has continued to perpetuate throughout the year.

And as it's continued to hang on, it's continued to have more of an impact. I think that's what you're seeing across not only our results in Q3, but the results of the industry in Q3 and comparable time frame.

So the great thing about the industry is people are going to maintain their vehicles. And just Jeremy made the comment earlier, we're doing everything we can to be best positioned in those categories, maintenance, repair, failure categories you have the best inventory availability in every market we serve to have the best service in every market we serve and then to go out and earn that business as it continues to come back. But we know it will as the Car Parc continues to age and people maintain their vehicles.

So we feel good about where we are. I think the trend you're talking about is just the trend and it will begin to reverse as we all know. And when you look back to the tough -- historically tough years in this industry, the 2017s and the 2008, back in those time frames, when you look at the following year, nobody has a crystal ball, but when you look at the following year, that we did see a bounce back, and we did see the customer returns. So we're confident that, that is going to happen in this scenario as well, and we're going to be ready for it.

Zach Fadem *Wells Fargo Securities - Analyst*

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Got it. I appreciate the thoughts there. And then your outlook would imply some I guess Q4 year-over-year operating margin easing relative to the declines we saw in Q2 and Q3.

You mentioned lower SG&A per store, so first of all, any colors on the drivers, be it slowing investments or otherwise? And then on your gross margin, you've had just really strong margin performance, offset in part by Canada. But any thoughts on this dynamic going forward?

Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Zack, I think you've outlined the pieces well. It does start a little bit with just the top line expectations and the leverage benefit that you get is as you think through a quarter that does have the easiest comparisons from last year and at least, somewhat of a benefit from a weekday perspective with the Sunday.

And even in gross margin, we feel like it's been consistent throughout the course of the year. We continue to believe that, that will be solid and in line with really the guidance we've said it all year long. Or at least our full year will come in, obviously, within that guide.

From an SG&A perspective, it's not necessarily a change in the cadence of the investments. But as you remember, as we move through 2023, we ran up fairly significant within the course of that year.

But things just like the depreciation overhang starts to run up against easier comparisons is a lot of those investments were in place before the fourth quarter and there's less of a year-over-year delta there for some of what we would have done in 2023, that we've been lapping more significantly in the previous quarters this year.

Operator

Christopher Horvers with JPMorgan.

Christopher Horvers *JPMorgan Chase & Co - Analyst*

A couple of follow-up questions. First on the 1 last Sunday. If I recall, it's a pretty modest benefit and less than what others have quoted because of the mix difference. So can you talk about how much that is from a comp perspective? And does it roll into total sales or in comp? And then was there any benefit related to that in the third quarter?

Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Yes. So third quarter was pretty even up from that perspective. Fourth quarter, when we have a Sunday difference can be a little bit variable just because the timing of the holiday can impact that, too. And usually, we would say it's somewhere in the, call it, maybe 30, 40 basis point range, depending on how you measure it, but that's a benefit to comp and total sales.

Christopher Horvers *JPMorgan Chase & Co - Analyst*

Got it. And then on the tariff side, I think in 2022, you talked about total direct and indirect exposure to China of around 30%. Is that right? And maybe how far does that come down?

And on the tariff side, I don't think the tariffs went away, and I think it was around 25%. Is that right? And if it does go up to 60% to follow on that prior question, like the consumer does feel like they sort of had it up to here in terms of taking inflation what gives you the confidence that you'll be able to pass that through?

Brent Kirby *O'Reilly Automotive Inc - President*

Yes, Chris, good follow-up on that. This is Brent. I can start. A couple of thoughts there. We think about the China exposure, that has been significantly reduced, probably in the tune of 500-plus basis points to where it was several years ago. So like I said earlier, we

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feel confident with the work the teams have done there to help reduce some of that exposure.

And to your point on the percentage, Who knows where -- what those percentages will be. And it's hard to set and forecast a scenario we haven't seen before what that would play through at, especially at a percentage as high as 60%. At this point, I have to believe where we were able to pass it on in the 20%, 25% range effectively in the past that we still have the ability to do that as we move forward.

If there's a tariff out there that is excessive to the percentages you're talking about, that may be a first for the industry, and we'll have to see how we deal with that at that point. But I think that's a little bit into the future for me to be able to make a comment on at this point.

Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Yes, Chris, I think the only thing I would add there is historically, our industry has been very disciplined in how we pass through those cost increases. And the demand that meets those higher price levels is very resilient because of the critical nature of transportation needs.

And so if you have a failure on your vehicle, you're going to need to replace it and you're going to need to move forward. I think what is most undetermined what we'll have to see is just the broader impact to the consumer because it's not obviously just what we sell that could be harmful from an inflation perspective.

Would we see a weakened consumer that now has to adjust and find ways to save money wherever they can. So that's where we think that -- in the past, when a consumer has been under pressure, they still have to make repairs. But with that broader pressure, cause them to try to save money and defer in some way or trade down.

And those are things that are kind of the second level of effects that we're yet to see. But that would be probably more likely to have an adverse impact to our consumer base than the industry not being very disciplined because we historically always have -- because of the inventory investments required, the inelasticity of what we sell.

Operator

Scot Ciccarelli with Truist.

Scot Ciccarelli *Truist Securities, Inc. - Analyst*

So you did make the comment that new stores are exceeding expectations. Given that factor in the broadly higher construction cost environment that we are seeing, can you provide any kind of update in terms of how people should be thinking about new store economics, i.e, store costs, new store productivity, payback, et cetera?

Jeremy Fletcher *OReilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Yes. No, I appreciate that question, Chris. We usually -- oh, Scot, I'm sorry, we usually get -- don't get too detailed on the specifics of that model other than the cost of the new stores. And when we own the store, that's kind of approaching that $3 million perspective now.

I think for us, historically, that model has just continued to improve from an economics perspective, we feel good. And that, in part, informed some of our decision to be a little bit more heavily into own stores over the course of this year and what you've seen in the mix of our new store count.

Just the productivity both from a ramp perspective and then just kind of that kind of mid-level maturity point at five or six years has continued to trend well. And for sure, over the last few years, that's been the beneficiary of a rising tide within our total business. But we've been pleased that that's continued to be resilient even as we've had a little bit more challenged year.

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

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Yes. Scot, this is Brad. Just maybe to reiterate, I appreciate you asking about growth. We're really excited to announce our 200 to 210 at new stores for 2025 continues to be our best way to invest in our business.

And when we talk about the productivity and we talk about the ROI, it's on those new costs. I mean in the last couple of years, yes, we've seen a lot of inflation in construction costs, but we continue to be even more pleased even on those new numbers.

And so our teams are just doing an incredible job with site selection. Our construction teams continue even though they've had a lot of headwinds from an inflation standpoint and the cost to build standpoint, rent factors, things like that. They've continued to look for ways to get more efficient as we continue to scale.

And then our field teams continue to put together just unbelievable teams backed up with our supply chain and our regional DCs and our hub stores. And that all equals even though we've seen a lot of inflation. That's why we're ramping up. I couldn't be more happy with those returns, and that's why we're ramping up to 200 to 210 for '25.

Operator

Steven Zaccone , Citi.

Steven Zaccone *Citigroup Inc. - Analyst*

I wanted to focus on the potential recovery in the business. How do you think that plays out, DIFM versus DIY? You've mentioned looking at history that you see a bounce back after some years of softness. How do you think that plays out by the different segments?

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Yes, great question. Steven, this is Brad. So even though we weren't necessarily pleased with our performance on either side of the business, I kind of -- to kick off the question. I want to frame up that we're -- we feel really good about the way our teams continue to take share on the DIFM side.

And so when you think about the overall market getting back to norms over the short to midterm here and the way the complexity and all those things are going to weigh in on people being able to work on their own stuff. We continue to see an opportunity on both sides. It's obviously going to be outsized on the DIFM side.

And so I think, generally speaking, the DIFM business, most likely is going to stay a little bit more resilient. That said, the -- I think it's balanced with the fact that the DIY business has been more impacted. And so when that consumer comes back, it could come back in a reasonably good way. And there could be some catch-up to do. There could be some things like that.

And so generally speaking, I think DIFM is going to continue to stay a little bit more steady and resilient. But I also think that DIY, while it's a little bit more uncertain, I still feel like it has plenty of opportunity to get more healthier in the next 12, 18 months.

Steven Zaccone *Citigroup Inc. - Analyst*

Okay. Great. And then just a follow-up on the DIY side. I'm sure you've gotten the question in the past, but some of the mass channel and the warehouse clubs, we've heard about them getting more competitive. Have you seen that impact your business at all as you think about maybe pricing or just overall traffic?

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Yes, sure. So those type competitors, they're -- they kind of dabble or pedal in some of our lines. A lot of that stuff is, the more discretionary types of less hard parts and things like that, that would be tough overall for them to compete and have the SKU proliferation and things like that.

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But really, we saw a huge opportunity, as you know, during the pandemic, where some of those were closed and service was closed, and so less people were going through kind of their parts section, so to speak, at the mass retail. And there's no doubt that we saw some recovery from those folks. They do a good job on a lot of fronts. But nothing necessarily happening different in 2024, Steven.

We saw some of that happen over the last couple of years. And so we have our head in the sand if we said we didn't maybe give a little bit of that back. But when we look at what we did during the pandemic versus mass retail, when we talk to our store team members and we look at our CSAT scores and we look at customer data and what customers are telling us, most of that, what we gain, we continue to see is very sticky.

Customers continue to tell us that curbside has worked very well for them, Buy Online, Pick Up In-Store continuing to not have to go get stuck in a big parking lot going into a big box versus being able to get into our neighborhood store in and out, professional pats people trusted advice. So we continue to have a lot of confidence, but the majority of that was sticky.

Those folks are always going to sell commodities. They're always going to be very sharply priced, but we continue to have confidence in our ability to overcome that with our with our service model in our smaller box.

Operator

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

Brad Beckham *O'Reilly Automotive Inc - Chief Executive Officer*

Thank you, Ali. We would like to conclude our call today by thanking the entire O'Reilly team for your continued hard work and dedication to our customers in the third quarter.

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 lines at this time, and have a wonderful day, and we thank you for your participation.

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