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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, and welcome to the O'Reilly Automotive, Inc. Third Quarter 2024 earnings call. My name is Ali, and I will be your operator for today's call. At this time, all participants are in a listen only mode and later we will conduct a question-and-answer session. During the question-and-answer session. If you have a question, please press star one on your touch tone phone. I will now turn the call over to Jeremy Fletcher. Mr. Fletcher, you may begin.

Jeremy Fletcher - *O'Reilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Thank you, Ali and 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-10K for the year ended December 31st, 2023, 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 Brad Backham on.

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

Thanks, Jeremy, and good morning, everyone, and welcome to the O'Reilly Auto Parts Third Quarter Conference Call. Participating on the call with me this morning are Brett 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 out 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 a lean at the end of our quarter and September and Milton following shortly after our quarter ended October, along with substantial flooding in North Carolina created some very

trying circumstances. As for our teams, our customers in our communities. These events impact not only in the direct half of the storms, but also multi teams across our store, distribution and support network to 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 the storms. I'm so 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% stacked on top of an impressive 8.7% and 7.6% third quarter increases in 2023 and in 2022, respectively. As impressive as our multiyear sales growth has been. Our sales results for the third quarter of 2024 were below expectations and 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 continued 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 a lean 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 10s professional comps in the prior year in the 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 continue 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 category, but we also continue to see customers prioritizing the better and best level products on the value spectrum with as many customers trading up on the spectrum as those trading down to entry-level products. Both of these dynamics risk, 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 noted in the past, these categories did not rise a significant portion of our business and typically are not primary drivers of comparable store sales performance. That said, this is an area where consumers can pull back when being more cautious with their spend and in turn, create some volatility during pressure times. We are also seeing a trend of softness across some repair categories impacted by a cumulative wear and tear on vehicles. We firmly believe that our experience store teams of professional parts people supported by our robust tiered distribution network, offer the best combination of service and availability in the the industry. We remain confident in our ability to outperform the market within these repair cost 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're experiencing today is not reflective of any change in the core demand drivers in the automotive aftermarket, the North American car park 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 pocketbook in an environment of uncertainty surrounding price levels. Macroeconomic conditions in an upcoming election. Caution as demonstrated by consumers is more impactful in our DIY. business as these consumers tend to be more economically pressured and perform work on their vehicles out of necessity. RDIY. customer base continues to represent slightly over 50% of our business. Even with the nondiscretionary 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 we'll prioritize keeping their vehicle in good working condition. This is especially true is 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 present persist as we finish out 2024 and into next year, we are confident in 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 wet weather and consumer demand dynamics during the holiday season, as well as potential impacts this year from the November election. We do expect to benefit in the fourth quarter as we lap our easiest comparisons of the year. I have one 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 the

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 are high bar performance in the standards we have said 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 is 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 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 DR business. However, we were able to offset this headwind with strong merchandise margin performer once 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 is stable and would anticipate seeing a mix of both incremental cost improvements and modest inflation pressure as we finish out 2020 for these cost dynamics are coupled with the 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, which dialing in our staffing levels to match business conditions and took appropriate steps to manage expenses as we sell incremental price Essure to sales in the third quarter, however, our SG&A flexibilities limited somewhat by pressure that we saw in self-insurance costs 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 low 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 2020 for 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, our 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%. A 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 Q3 stores pushed back due to delays in construction and final permitting. However, we remain on track to open 190 to 200 new stores in 2024 in 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 generating high returns on new store locations is centered around one primary determining factor the quality of the store team behind

the counter, the day we opened doors. We work hard to support our new store teams by executing a rigorous playbook to select great sites and formed 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 is supporting roles and regional sales and field leadership. Perpetuating our culture to promote from within philosophy ensures that we have engaged leadership teams with proven success. Yes, in executing our store operating model. Moving on our capital expenditures for the first nine months of 2024, \$ 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 two facilities opening this year. As well as the continued progress on our new Mid-Atlantic, DC and Stafford, Virginia, which will open in 2025. I want to express my deep gratitude for the hard work from all the teams involved in the successful expansion of our industry leading distribution network. Because 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 - O'Reilly 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. Fourth-quarter sales increased \$161 million, driven by a 1.5% increase in comparable store sales and a \$ 66 million non-comp 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 and \$16.8 billion. Our Q3 effective tax rate was 21.5% of pretax income, comprised of a break at 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 total of certain tax periods. Also variations in the tax benefit from share-based compensation create fluctuations in our quarterly tax rate. Diluted EPS for the quarter increased 6% with our year to date diluted EPS increased 7%. We have updated our EPS guidance range to a range of \$40.60 to \$41.10. \$0.15 reduction to our range is driven and 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 nine 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. For our expected free cash flow guidance remains unchanged at a range of 1.822 \$0.1 billion. Our AP as a percent percentage of inventory finished the third quarter at 129%, down from 131% at the end of 23. Ratio was slightly above our expectations, driven by the timing of inventory investments throughout the year. We continue to expect to see moderation in our APT percentage through the end of 2024 and expect to finish the year at a ratio of approximately 127%. Moving on to that, 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 the 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. 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 0.6 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 assure 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 the operator to return to the line, and we will be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. I will now begin our question-and-answer session. If you have a question, please press star one on your phone. If you would like to remove to be removed from the queue, please press star two. We ask that while posing your question. You please pickup your handset if listening on speakerphone to provide optimum sound quality, please limit your questions to one question and one follow-up question. Once again, if you have a question, please press star one on your phone. Thank you.

Our first question is coming from Bret Jordan with Jefferies. Your line is live.

Bret Jordan - Jefferies - Analyst

Hey, good morning, guys. Born and bred rep. A question on supply chain with the Virginia DC opening and obviously you've got one in Devon's mass. Do those 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. Hey, Bret, 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 to have a lot of opportunities to continue to store. And so, we feel like it's going to really paved the way for us to open up that corridor. To your point. When we think about the distance between Stafford and Devon's, they'll likely probably will at some point be another one that would be a fill in there. But the super excited to get started on having that capability in that location. Yes, Brett, the spread. I may just jump in real quick. Brett said it pretty well. But I think the way I'd think about it, you know, we still have such an opportunity in the northeast part of the country. You know, depending where you draw the lines, you can come up with a third of the population of the US. So we're extremely excited to have a lot of opportunity in New England. And then when you get into Northern Virginia, the DC, metro, Baltimore and 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 trying to stretch ourselves too far out too quick in between those two DCs. Those are extremely competitive markets. A lot of store opportunity, a ton of DIFM. opportunity, lot of retail opportunity, but we'll work those range from Asad 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, it's 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, I have a positive or negative for sales teams?

Brent Kirby - O'Reilly Automotive Inc - President

Yes, good question, Brett will 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. You know, we were we were fairly fortunate in the Florida market here of late, but you don't have had quite a bit disruption with Helene specifically in South Georgia and then up in western North Carolina. And we obviously had especially in that last week, there's a lean hit. We saw some disruption. But I think what we would say, Brett, were a little bit careful with us being disappointed with our comp overall. We wanted to be a little bit careful talking about, you know, too many puts and takes were not happy with the 1.5% comp, but if we had to put a number on it, it would have been pretty immaterial. It would have been possibly in the 10 to 15 basis points maybe in the quarter in terms of a lean and then overall in the fourth quarter is yet to be seeing kind of what we'll make up there. But I think when you look at third and fourth quarter, even with those bad storms, I think whether there's a net neutral.

Bret Jordan - *Jefferies - Analyst*

Great. Thank you.

Brent Kirby - *O'Reilly Automotive Inc - President*

Thanks, Bret.

Operator

Thank you. Our next question is coming from Simeon Gutman with Morgan Stanley. Your line is live.

Simeon Gutman - *Morgan Stanley - Analyst*

Good morning, everyone. Thanks for the question. From a Brazilian and anyone else components I want to ask you made the comment about headwinds should be short-lived. And I think that makes sense. You look at the industry, the industry got weak on maybe the year three quarters before your business gone a little softer. So why does it flips soon? one about what what confidence do you have? Is there anything about like on a micro basis on on failure rates? Or are there any markets that you have where you've had some softening and NRE strengthening that you can point to what I can help us think about timing? I know there's no crystal ball, but it's a tricky are tricky setup.

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

Yes, great. Great question, Simeon, I tried to do the best I can here. So I think generally, when you look back at it, we don't want to live in pandemic times and we obviously saw a lot of success there. So we've built our base, you know, definitely several step changes there in all both sides of the business, obviously, more predominantly on the preferred national side. But when we think about a year like this and again, we've said this allies, you've heard us say it a lot. But you know, in my 28 years in the industry and with Bill Reilly, we just lived this so many times that while we're not happy with our 1.5% comp and really our year to date, the reason that that I called out short-lived or earlier is just because when we've lived this in an election year in times of higher inflation and all the things that have been on the consumer this year with just the uncertainty feel once we get past 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, you know, 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. And maybe some of the only thing I would add there specifically do are we seeing anything in any granular way that's pointing us to that at this point, we would say no to that. To that question would be clear about that. You've given 1.5% comp in the third quarter? We are at where we're at the confidence that we have is to have 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 that best position possible as condition to 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 does it seem like we're participating in the industry slowness until until it's persisted for a while. And we want to be the first ones to that to come out. And I think our teams have demonstrated the ability to do that over the course of time from a consistency perspective and a. And so I think that, coupled with what Brad said about what we see from an industry perspective over the long term gives us confidence that that we're going to be well positioned to to move forward from this point.

Simeon Gutman - *Morgan Stanley - Analyst*

Makes sense. And then quick follow-up question on market share. two years ago, the spread O'Reilly to industry was significant and it blew out this year still taking share. It looks like it's now in a little when you as you approach how you forecast next year. First, you always put a market share component into your own company expectation. And then how do you how do you figure where that lands into the normal year?

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

Just one of the puts and takes Excellent question, Simeon and one that we'll spend a fair amount of time on between now and next quarter when we when we provide our guidance for next year, for sure are Our expectation is that because of the team that we have our advantages from a distribution availability perspective and the momentum we created that day, 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 as we finalize that working with in the next quarter, what our expectations are for 2025, that it will include a component of that consistent with where we've been really for much of our history.

Simeon Gutman - *Morgan Stanley - Analyst*

Fair enough. Good luck, everyone.

Operator

Thank you. Our next question is coming from Michael Lasser with UBS. Your line is live.

Michael Lasser - *UBS - Analyst*

Good morning. Thank you so much for taking my question. These teams have been a year where uncharacteristically O'Reilly has just got this gauge the demand in the market and has had to dial down a couple of times. Now it's we're only going to be a few months away from how are you starting to think about 2025. If we go through the next few months, let's say, the 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 at the second part of that question is if the industry is going to have another sluggish year next year, what is the Riley think the right level to comp is in order to generate the same and margin expansion on the on the expense side, put another way how low can come to the next year without having some deleverage we use your SG&A per store still grow 2% to 3% or higher in if indeed trends remain sluggish next year. Thank you.

Jeremy Fletcher - *O'Reilly Automotive Stores Inc - Chief Financial Officer, Executive Vice President*

Yes, Michael, thanks for the question is this is Jeremy. You know, I think you're accurate in saying that that at the year, like we're having this year is uncharacteristic. I think for us for our history, although on the though it's not completely, it's not completely unprecedented. We've had years like this. Our industries had years like this El. sake a year for us having a near term focus to trying to predict exactly the sequence and timing of exactly how the business performs. And news out of it is one that we've got some some insight into a bit, but frankly, we don't have the same yield. We don't have a crystal ball that that all of you don't have in will. I will have to evaluate what our best read is when we establish our guidance for 2025 . So it's 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 how we form yield kind of from a concrete perspective, what those opinions are. I think that same answer applies to how we think about the expense structure and and what our read is, what overall cost levels are going to be next year. And in how we think the components of what our 2025 guy will be comprised of what benefit we might think we see it seems to inflation in those things. I think maybe to step back from near term, some questions that they tried to pull forward our guidance setting process for next year. If you just talk a 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, provide strong returns for how we're investing in the business and in So I take a you know, as we put together those expectations for 2025 years, you'll see that, you know, a similar conviction around or the success of our business that we've had underlying our results for a long time.

Michael Lasser - UBS - Analyst

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

Brent Kirby - O'Reilly Automotive Inc - President

Yes. Hey, Michael, this is Brent. Great question. And I can start, and these guys can add in, you know, written in a most recent point of reference, we have on any kind of scenario like that would be back in 2018. When we had the tiers to 2017, 2018 before, you know, honestly, we were able to pass those on those increased costs through in selling price. And really that wasn't just us that was the entire industry. So that was kind of a non-event in terms of some of those components. What I will tell you since then. And since COVID and through COVID, you know, our teams, our supply chain team, sourcing teams, merchandise team has done a fantastic job continuing to look at alternate new 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're still not have some dependencies there we do in 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 place, specifically with China, I still feel confident and 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, though, the only thing I would add or 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 in there. They will be what they 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 Brian talked about. So, we feel good that we'll be able to handle that. It becomes.

Michael Lasser - UBS - Analyst

Thank you, very much and good luck.

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

Thanks, Michael.

Operator

Thank you. Our next question is coming from Zach Fadem with Wells Fargo. Your line is live.

Zach Fadem - Well fargo - Analyst

Good morning. At this has been asked a couple different ways, but by taking a different angle here, are just curious as you look back over the course of the year, if you can pinpoint when specifically that deferred maintenance dynamic started to materialize in your data and as you look to Q4 and beyond on your thoughts on what the drivers historically tend to be that that unlock our catch up pent up demand, be it lower gas prices which were starting to see today or whether any thoughts there?

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

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

know, as you mentioned, maintenance, we actually are are very pleased with our maintenance categories. You know, we look at it more from Pino. The biggest part of our business does nondiscretionary, you know, failure, repair type jobs. Some of that stuff can still be a little bit delayed. We're fairly pleased with our with our failure and kind of repair categories. Maintenance has been really good called that out in my prepared comments, things like oil changes of 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. You know, really what we continue to see, but what we see, what we saw more pronounced in two three 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, you know, from from good to better and better the best. We did see some offset in that in Q three, while we still saw some customer, there's trading from better to best. We did see some that were moving down to some extent they're in Q three. So that's kind of what I'd say in May. Let Brent?

Brent Kirby - *O'Reilly Automotive Inc - President*

Yes, they did. The other thing I would say, you know, is a great question. I mean, the trend has been everything Brad just described as kind of been a theme that has continued to perpetuate throughout the year. And as it's 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 was not only our results in Q3, but at the results of the industry in Q3 and comparable timeframe. 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 beef Mizuno, best positioned in those categories, maintenance, repair, their 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 are in that business as it continues to come back. But we know it will has carpark 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 the trend and it will begin to reverse as we all know. And when you look back to the top historically tough years in this industry, the 2017s and the 2018's 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 is well, and we're going to be ready for it.

Zach Fadem - *Well fargo - Analyst*

Got it. 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 far. First of all, any any colors on the drivers, be it slowing investments or otherwise? And then on your gross margin, you've had just really strong merch margin performance offset in part by Canada. But any thoughts on this dynamic going forward?

Brent Kirby - *O'Reilly Automotive Inc - President*

Zach, I think you've outlined that piece as well. It does start a little bit with the just the top line expectations in the deleverage benefit that you get Asia as you think through a quarter that that does have the easiest comparisons from last year and at least have a somewhat of a benefit from a weekday perspective with the Sunday in your gross margin. We've we feel like has been consistent throughout the course here. We continue to believe that that will be solid and in line with really the guidance. The guidance we've said it all year long or at least our full year will come in. I would say within that within that guide, from an SG&A perspective, it's not necessarily a change and the cadence of the investments. But as you remember is we as we move through 2023, we ran out fairly significant within the course of that year. But things just like the depreciation of overhang starts to run up against easier comparisons is a lot of those investments were in place before the fourth quarter in. 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 some more significantly in the previous quarters this year.

Zach Fadem - *Well fargo - Analyst*

Got it. Thanks for your time, guys.

Operator

Thank you. Our next question is coming from Christopher Horvers with JPMorgan. Your line is live.

Christopher Horvers - JPMorgan - Analyst

Thanks, good morning. Have come a couple of follow-up questions on first on the one less Sunday and from our call, it's a pretty modest benefit and less than what others have quoted because of the mix different. So can you talk can you talk about how much of that is from a comp perspective and that rolling the total sales are in comp? And then on, was there any benefit related to that in the third quarter?

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

Yes. So Q3 was pretty was pretty even up from that perspective. Q4 where we have a Sunday difference can be a little bit variable just because the timing the holiday can impact that to usually, we would say it's somewhere in the corner how users are in.

Christopher Horvers - JPMorgan - Analyst

2022, you talked about in a total direct and indirect exposure to China of around 30%. Is that right? And maybe help how far is that come down? And on the tariff side, I don't think the tariffs and rent went away, and um, I think was around 25%. Is that right? And you know, if it does go up to 60%. I mean I'll follow on that prior question, Mike, the consumer does feel like, you know, they sort of had it up to here in terms of taking inflation on what gives you the confidence that we will pass that through?

Brent Kirby - O'Reilly Automotive Inc - President

Yes, Chris, good follow-up on that. At this is Brent. I can start, you know, a couple of thoughts there. When you think about the China exposure, you know, 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 feel confident with the work the teams have done there to help reduce some of that exposure. No. On then to your point on the percentage, who knows, you know, we're what those percentages will be, and it's hard to certain forecast this scenario we haven't seen before, what that would play through at especially the percentages high 60% at this point. I have to believe where we were able to pass it on in the 2025, percentage 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 no excessive to the percentages you're talking about that may be a first for the industry and we have to see how we deal with that at that point. But I think that that's a little bit into Camino into the future for me to be able to make it make a comment on at this point yet.

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

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 in the demand that meets those you those higher price levels, is there a resilient because because of the critical nature of transportation needs in is so if you if oh, if you have a failure on your vehicle, you're going to need to replace it and you're going we need to move forward. I think what is most undetermined? Well, what we'll have to see is just the broader impact to the consumer because it's not obviously just wise what we sell that, that that could be harmful from an inflation perspective. We see a weaker consumer that now has a just and find ways to save money where ever they can. So that's where we we think that, yes, that did in the past when a consumer has been under pressure, they think they still have to make repairs. But with that broader pressure caused because I'm trying to save money in deferred subway or trade down in there, those are things that you are kind of the second level effects that we're yet to see that would be probably more likely to have an adverse impact to our consumer base than than the industry not being very disciplined because but because it is we've historically, we have because of the inventory investments required the year a year or the inelasticity of what I what we sell.

Christopher Horvers - *JPMorgan - Analyst*

Makes sense. Thanks very much.

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

Thank you, Chris.

Operator

Thank you. Our next question is coming from Scot Ciccarelli with commenced. Your line is live.

Scot Ciccarelli - *commenced - Analyst*

Good morning, guys. So you didn't make the comment that you did make the comment that new stores are exceeding expectations. And 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?

Brent Kirby - *O'Reilly Automotive Inc - President*

Yes. No, I appreciate that question. At present? We usually on Scott, I'm sorry, we used to get them. You don't get too detailed on the specifics of that model, other than the cost of the new stores and we own Historia, that's kind of pushing that \$3 million perspective. Now, I think for us historically, that model has just continued to improve. From an economics perspective, we feel fairly good and that imparting for earned some of our decision to leave a little bit more heavily into your stores over the course of this year. And what you've seen in the mix of our new store count, the to just the productivity of both from a rate perspective and then just kind of hit that they're kind of mid-level maturity. We had five or six years has continued to trade well. And for sure, over the last few years, that's been the beneficiary of 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*

Yes, Scott, Scott, this Brad, just maybe to reiterate that I appreciate you asking about growth. You know, we were really excited to announce our 200 to 210 net new stores for 2025 continues to be our best way to go to invest in our business. When we talk about the productivity and we talk about the ROI, it's on, um, you know, those new costs mean in the last couple of years, yes, we've seen a lot a lot of inflation in construction costs that we continue to be even more pleased even on those new numbers. And so, in our teams, we're just doing an incredible job site selection. Our construction teams continue, even though they've had a lot of headwinds from a from an inflation standpoint in the cost to build standpoint, risk 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 couldn't be more happy with those returns. And that's why we're ramping up to 200 to 210 for 2025 data.

Scot Ciccarelli - *commenced - Analyst*

I'll take the rest off-line. Thank you.

Operator

Our next question is coming from Steven Zaccone with Citi. Your line is live.

Steven Zaccone - *Citi - Analyst*

Great. Good morning, everybody. Thanks very much for taking my question. I wanted to focus on not the potential recovery independent. How do we think that played out DIFM. versus DIY.? You mentioned looking at history that you see a bounce back after 10 years of softness. How do you think that plays out by out of the different segments?

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

Yes, great question and good morning, Steve. Is Brad. So even though we weren't necessarily pleased with our performance on either side of the business side, kind of to kind of kick off the question I want to frame up, the were, you know, we feel really good about the way our teams continue to take share on the DIFM. side. And so when you think about the the overall market getting back to norms over the short to midterm here and the way the complexity and you know, all those things are going to weigh in on 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, you know, the I think it's balanced with the fact that the DIY. business has been more impacted. And so on that consumer comes back, we could come back in a in a reasonably good way. And you know, there could be some catch-up to do. There could be some things like that. And so generally speaking, I think, you know, DI. events going to continue to stay a little bit more study and resilient. But I also think that the why what's a little bit more uncertain. I still feel like as plenty opportunity to get more healthier the next 12, 18 months.

Steven Zaccone - *Citi - 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 you know, some of the mass channel in the warehouse clubs, we heard about them getting more competitive, hadn't 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 in, oh, they're they kind of dabbled or pedal and some of our lines, you know. So a lot of that stuff is the more discretionary type stuff, less 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. But I'm 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, of the mass and mass retail. And there's no doubt that we saw some some recovery from those folks. You know, they do a good job on a lot of fronts, but nothing necessarily happening different in 2024. For Stephen. We saw some of that happened over the last couple of years. And so, you know, 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 it, our CSA scores and we look at our customer data and what customers are telling, yes, no, most of that, what we gain we continue to see is very sticky. Customers continue to tell us that the curbside has worked very well for them, buy online pickup in-store, continuing to not have to go get stuck in a big part of log going into a big box versus being able to get into our neighborhood store in and our professional parts people trusted advice. So we continue to have a lot of confidence that the majority of that was sticky. Those folks are always going to sell. Commodities are always going to be very sharply priced, but we can continue to have confidence in our ability to overcome that with our with our service model in our smaller box.

Steven Zaccone - *Citi - Analyst*

Appreciate all the detail. Thanks.

Operator

Thank you. We have reached our allotted time for questions. So I will now turn the call back over to Mr. Brad back 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 thing and we thank you for your participation.

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