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PRESENTATION

Operator

Good morning. My name is Latasha and I will be your conference operator today. At this time, I would like to welcome everyone to the O'Reilly Automotive first quarter 2013 earnings release call. All lines will be on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator instructions). Please limit yourself to one question and one follow-up question due to time. (Operator instructions). I will now turn the call over to Mr. Tom McFall, CFO. Sir, you may begin.

Tom McFall *- O'Reilly Automotive - CFO & EVP, Finance*

Thank you, Latasha. Good morning, everyone, and welcome to our conference call. Before I introduce Greg Henslee, our CEO, we have a brief statement.

The Company claims the protection of the Safe Harbor for forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as expect, believe, anticipate, should, plan, intend, estimate, project, will or similar words. In addition, statements contained within the earnings release and on this conference call that are not historical facts are forward-looking statements such as statements discussing, among other things, expected growth, store development, integration and expansion strategy, business strategies, future revenue and future performance. These forward-looking statements are based on estimates, projections, beliefs and assumptions and are not guarantees of future events and results. Such statements are subject to risks, uncertainties and assumptions, including but not limited to competition, product demand, the market for auto parts, the economy in general, inflation, consumer debt levels, governmental regulations, the Company's increased debt levels, credit rating on the Company's public debt, the Company's ability to hire and retain qualified employees, risks associated with the performance of acquired businesses, weather, terrorist activities, war and the threat of war. Actual results may materially differ from anticipated results described or implied in these forward-looking statements. Please refer to the risk factors section of the annual report on Form 10-K for the year ended December 31, 2012, for additional factors that could materially affect the Company's financial performance. These forward-looking statements speak only as of the date they were made and the Company undertakes no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

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

Greg Henslee - *O'Reilly Automotive - President & CEO*

Thanks, Tom. Good morning, everyone, and welcome to the O'Reilly Auto Parts first quarter conference call. Participating on the call with me this morning is Tom McFall, of course, our Chief Financial Officer; and Jeff Shaw, our Executive Vice President of Store Operations and Sales. David O'Reilly, our Executive Chairman; and Ted Wise, our Executive Vice President of Expansion, are also present.

I would like to begin today's discussion by thanking our 56,000 team members for their continued hard work and dedication to our Company's success. As we expected heading into 2013, the first quarter was a challenging quarter to drive robust sales growth increases due to the difficult comparisons to 2012. To remind everyone on the call, in the first quarter of last year we delivered a 7.4% comparable store sales increase driven by the pull forward of spring business into the first quarter as a result of the early warm weather in most of our markets and the 1.3% benefit from Leap Day. In addition to the weather-related headwinds, the expiration of the payroll tax holiday and the timing of Easter falling into the first quarter of this year versus the second quarter of 2012 made it tough to generate strong comparable store sales increases.

Despite these significant headwinds, through our teams' continued focus on superior customer service we were able to sustain the solid sales trends from the fourth quarter of 2012 into this quarter and generate a positive comp of 0.6%, which was within our comparable store sales guidance range for the quarter of flat to 2%. We estimate that the impact from the calendar shift in the first quarter for both weekday and Easter negatively impacted our comps by approximately 1.5%. So on an adjusted basis, our team delivered a 2.1% comp on top of a similarly adjusted 6.1% comp from the first quarter of last year. So we are reasonably pleased with our performance against these tough comparisons.

Our first-quarter operating profit as a percent of sales decreased 34 basis points, but as we previously stated on last year's call, operating profit in the first quarter of 2012 benefited approximately 15 to 20 basis points from Leap Day since we realized the sales benefits of Leap Day with essentially no additional fixed costs.

Excluding the Leap Day comparison, the remaining deleverage is the result of comparing to strong SG&A leverage in 2012 on robust sales as our SG&A spend in the first quarter of 2013 was in line with our expectations. We are pleased with our team's ability to generate a 1% increase in operating profits over last year, considering the significant comparison headwinds we faced in the first quarter.

The solid operating performance, coupled with a reduced share count from last year's buybacks and a lower tax rate, which Tom will discuss later the call, drove a robust increase in first-quarter earnings per share of 19% and sets us on the path for a strong year in 2013.

Now I would like to spend some time further discussing our sales results in the first quarter and provide a little color on our view of the macro conditions in our industry. From a comparable store sales percentage perspective, the quarter started out stronger than it finished due to the tough comparisons as a result of the early spring weather last year and the late spring we are having this year. This should bode well for our business as we move forward into the second quarter, and so far in April we are seeing a solid uptick in our comp store sales as spring weather arrives in many markets. The tough weather comparisons primarily affected our Central and Northern/Midwest markets, with these stores negatively impacting our comparable store sales performance by approximately 200 basis points.

While the drag in these markets is similar in magnitude to the last two quarters of 2012, the reason is different. The drag in the first quarter of 2013 was due to the very tough comparisons to the early warm weather in the first quarter of 2012, whereas the drag in the third and fourth quarters of 2012 was the result of the mild winter in the first quarter of last year. Based on the current sales volume trend, we expect these markets to return to historical patterns and be a contributor to comps for the remainder of 2013 as we face easier comparisons. The difficult comparisons arising from the early spring weather in 2012 and the timing of the Easter holiday affected the DIY business more significantly while the Leap Day comparison was felt equally on both sides of our business.

As a result and in line with our expectations, comps for our DIY business were negative in the first quarter but were flat when you exclude the impact of the calendar issues. Professional customer comps were positive with and without the calendar shift.

The acquired stores continue to out-comp the core O'Reilly stores and continue to be accretive to our overall comp results. However, the core O'Reilly stores comp positive for the first quarter when you adjust for the impact of Leap Day and Easter calendar shifts. We remain pleased with our progress of the acquired stores and the traction we are gaining with the professional customers in those markets and still believe we have substantial opportunities in the future to capture an increased share of this business.

As we have seen for some time now, overall comps in the first quarter were driven primarily by average ticket increases. This trend has been the result of the increasing complexity and longevity of vehicles on the road today and the associated higher cost of parts at the same time that we are continuing to see a larger percentage of our sales generated in the hard parts categories which carry a higher ticket average, especially when we compare to the impact of the early spring weather on the mix in the first quarter last year. I would like to add that inflation was not an outsized driver of our ticket average increase.

Our continued success in building out the professional customer business in the acquired markets resulted in increases in ticket counts on that side of the business with DIY ticket counts continuing to be under pressure. From a macro standpoint, we remain very confident in the long-term outlook for the automotive aftermarket. After adjusting for Leap Day, total vehicles miles driven in the US thus far in 2013 are flat to slightly up. While the rising gas prices from the fourth quarter of 2012 to the first quarter 2013 has not been helpful to our business, gas prices are relatively comparable to last year and we see the fall of gas prices heading into the second quarter as a positive for the summer selling season. While it's difficult to quantify, we have been negatively impacted by the lapsing of the payroll tax holiday, but as with other issues that impact the consumer's pocketbook in the short term, we expect that this impact will be short-lived and consumers will quickly adjust to the return of normal payroll tax rates.

We are encouraged to see unemployment slowly moving in the right direction, but the current rate is still high, which reduces commuter miles driven and contributes to a high degree of economic uncertainty. When we look at the long-range future of our business, we remain very optimistic about the fundamentals of our industry as the US vehicle fleet of 241 million cars and light trucks on the road at an average age of 10.8 years continues to age and go through more routine maintenance cycles and consumers continue to realize the value of investing in repairs of higher mileage vehicles. We expect to see the trend of increasing vehicle age to continue due to better engineering and manufacturing and are excited about the opportunities for O'Reilly to capitalize on these trends will into the future.

As we look forward to the second quarter, we would expect to see a continuation of the solid business trends we have experienced over the past two quarters and are setting our comparable store sales guidance at 4% to 6%. This guidance assumes a normal weather pattern through the second quarter and inflation at historic norms.

While the guidance range for the second quarter is a significant sequential increase from our first quarter results, the dollar volumes we are projecting are in line with our current trends and the guidance reflects the easing of comparisons from 2012. In fact, at the midpoint of our guidance range, the two- and three-year comparable store sales tax for the second quarter are lower than our first-quarter results.

The business thus far in April has continued on a solid trend and with the easier comparisons, our comp store sales results support our 4% to 6% guidance. As a reminder, from our release last year the sales progression in the second quarter of 2012 saw a weak April followed by a strong May and a weak June. As a result, June will be a critical month as we calendar the period when we really began to see the business in the Northern Plains and Midwest negatively impacted from the mild winter last year.

After performing within our expected range for comps in the first quarter, we are also reiterating our full-year comp store sales guidance of 3% to 5%. Within this comp guidance is our expectation that weather will be somewhat normal for the balance of the year and total vehicle miles driven will increase gradually as unemployment and the corresponding commuter miles slowly recover. However, we believe consumers will continue to be under pressure for the foreseeable future.

In addition, we continue to be very excited about the opportunity to develop long-term relationships with our professional customers in the acquired market and would expect these gains of hard parts sales and the increased complexity of repairs I discussed earlier to further drive increases in our average tickets.

I would now like to make a few comments regarding another strong gross margin performance for the first quarter. We are pleased to have maintained a very strong gross margin rate and the components of our gross margin results in the first quarter were very similar to the fourth quarter of last year on a sequential basis. On a year-over-year basis compared to the first quarter of 2012, we saw a 59 basis points improvement through an improved operating efficiency in our distribution centers and excellent shrink results. For the full year 2013, we are slightly raising our gross margin guidance from a range of 49.9% to 50.3% to a range of 50% flat to 50.4%, based on the better-than-expected first-quarter results.

Inherent in this guidance range is our expectation that industry pricing will remain rational and our merchandise teams will be able to continue their great work in incrementally improving acquisition costs but that these gains will be offset by a higher mix of professional customer business, which carries a lower gross margin than our DIY business.

We would also expect to see improvements in our distribution center efficiency, especially in our newer DCs. But as we have discussed on our last quarter's call, this improvement will be offset by a reduced benefit from capitalized distribution costs as compared to 2012 related to the store inventory expansion initiatives we completed throughout last year. We also anticipate maintaining our strong shrink results throughout 2013.

Before I turn the call over to Jeff, I would like to provide an update on our acquisition of a VIP Auto and provide some information on some initiatives we have planned to capture an increased share of DIY business. To date, our acquisition of the retail portion of VIP, comprised of 56 stores located in Maine, New Hampshire and Massachusetts, has been progressing smoothly. We have converted the computer systems in both distribution center and the stores to O'Reilly systems and conducted training to bring our new team members up to speed on the O'Reilly point-of-sale system and catalog parts lookup system. We'll be conducting resets of the interior, layout and decor over the next several months, which will allow us the space we need to deploy the inventory levels required to run our dual-market strategy. We will complete the final step of the integration when we change over the exterior signage in the fall. We would not expect to see a significant increase in sale volumes in these stores in 2013, but we are excited about the opportunities ahead of us in these new markets as we establish the O'Reilly brand and develop relationships with professional customers in these markets.

Finally, I would like to talk about some initiatives we have underway to capture a larger share of the DIY market. Growing our DIY business continues to be a primary focus for our Company and we believe we have a huge opportunity to increase our average store volumes based on industry averages. One of the initiatives we are in the process of implementing is a loyalty card program. This program is designed for our customers to track their purchases and earn points for dollars spent, which are then redeemable into coupons that can be used towards future purchases. The program will also include targeted promotions and special offers marketed exclusively to our loyalty program members. We are excited about the potential of the new program and believe it will allow us to enhance engagement with our customers to earn more of their business and capitalize on additional sales opportunities. We will also see benefits in accumulating customer purchase histories linked to the ability to use this information to direct our marketing efforts to the specific needs and purchasing patterns of our customers. Most of all, we see the loyalty program as an effective way to reward our customers and thank them for their continued business while creating a two-way value proposition that drives increased share of the DIY market. We are currently in the pilot phase of this program and began testing in selected markets this month. We will use this brief pilot to address any technical issues and plan to roll out the full program chain-wide by the end of the second quarter.

The last initiative I would like to discuss is the work we are doing to replace our point-of-sale transaction engine. This change does not affect the catalog interface that our team members and customers see, but rather is an enhancement of the system architecture that is the backbone of how we process transactions. We're implementing an industry-leading retail solution and replacing our legacy homegrown system. The new system allows us increased flexibility to implement more advanced and targeted promotions and enhance the customer experience with tighter integration between our in-store systems and our e-commerce efforts. The new system will also give us the tools we need to quickly address changing business needs and allow us to focus on continued enhancements in areas such as our electronic parts catalog, which are core competencies for our Company. We will be testing the new system in pilot stores in the back half of this year with full rollout chain-wide in the first half of 2014.

Before I turn the call over to Jeff, I would like to once again thank our team members for their strong execution in the first quarter and their continued dedication to providing the absolute best customer service in our industry to our loyal customers. I will now turn the call over to Jeff.

Jeff Shaw - *O'Reilly Automotive - EVP, Store Operations and Sales*

Thanks, Greg, and good morning, everyone. I would like to join Greg in thanking Team O'Reilly for their performance in the first quarter and for their unwavering commitment to providing the best customer service in the industry, day in and day out. The environment in our business was tough in the first quarter, just as we expected it would be. And when business is tough to come by, the service you provide to both the DIY and professional customers becomes even more critical. We have always believed that staying true to our discipline of going the extra mile for each and every customer develops the long-term relationships that allow us to continue to grow our business even in tough times. This commitment to the customer was at the heart of our decisions last year to both add inventory to enhance our store in-stock position and also maintain our store staffing levels to ensure excellent customer service. It was this commitment to the customer that we believe allowed us to grow our business in the first quarter even in light of the difficult comparisons.

The first item I would like to highlight today was our SG&A performance for the first quarter. During the difficult macroeconomic environments we faced in recent quarters, we have remained very focused on expense control. But I want to emphasize, and this is a comment we've made for the last several quarters, that we will be prudent in managing our expenses and under no circumstances will we make cuts that will endanger our ability to provide the top-notch customer service that develops those long-term relationships.

SG&A de-levered 93 basis points in the first quarter of 2013, based solely on the tough comparisons to last year, including the 15 to 20 basis point benefit in 2012 for Leap Day, which had no additional fixed cost. In terms of the total dollar spend on SG&A, we are pleased with the strong expense control we exercised in the first quarter as our SG&A dollar spend was on plan. For the first quarter, our per-store SG&A was flat in comparison to the first quarter of 2012, which saw the highest year-over-year growth of any quarter in 2012, in part because of the higher incentive compensation on the strong sales and operating income performance. We feel we have our SG&A spend dialed in for the current business trends and we expect full-year SG&A spend per store to increase approximately 0.5%.

Our first-quarter results and full-year expectations reflect our commitment to maintaining high customer service levels to grow the business while actively managing expenses. We have executed this playbook throughout our history and we have seen it proven time and again that consistent excellent customer service is the number one factor in earning and keeping our customers' business.

I would now like to touch on our distribution center operations. As Greg previously mentioned, our ability to drive cost-saving efficiencies in our DCs was a positive driver of our gross margin performance again this quarter. These continued efficiency improvements are consistent with our expectations as we actively manage costs to improve operating efficiency of our newest DCs.

The DCs have also been instrumental in supporting our inventory availability initiatives and their support has helped to drive increased store volumes in all markets. We are diligent in pushing the envelope to run our DCs leaner and more effectively and we currently have projects underway to improve our DC management systems, enhance labor scheduling and optimize our DC route network.

Next, I'd like to update everyone on some initiatives we have underway to further enhance the great customer service we provide. As we have discussed on prior calls, we rolled out our proprietary electronic parts catalog in the first half of 2012. OCAT, our electronic parts catalog, is a critical tool in the stores for providing top-notch customer service to both the DIY and professional customers. Because of this, we ran our new catalog side by side with the legacy third-party catalog to allow our team members to have the option of which one to use as they learn the new system and while further enhancements were made.

By the end of the first quarter, virtually all of our team members were using the new catalog based on its superior functionality and content. As a result, we eliminated the legacy catalog in April. We continue to capitalize on the features of our new system and will continually make improvements to the catalog to ensure our customers will benefit from the most robust catalog in the industry.

With the conversion to our new catalog complete, we are now focused on implementation of our proprietary business-to-business platform named First Call Online. This redesign of our B-to-B platform leverages the catalog improvements we've made in our electronic parts catalog and gives our professional shops access to enhanced product content and images as well as enhanced search and identification features. Ultimately, our First Call Online system is designed to be a proprietary business tool for our customers to locate and order the right part in the most efficient manner possible so they can keep vehicles moving through their base. The new system also enhances how we integrate promotions and incentives directed at our professional customers and allows us to manage the relationships in a seamless fashion. This system helps us form strong connections with our customers and the enhancements we are rolling out will make these ties even deeper. We have completed the testing on the new system in the first quarter and are currently in the process of rolling out the new system and switching our customers over from our legacy system, which we expect to complete over the course of this summer.

One last initiative I would like to report on is the continued traction we are seeing from the hub and store level inventory investments we made in 2012. Great service demands having industry-leading access to the parts customers need and we believe the investments we made last year are contributing to the sales momentum we are seeing in 2013. We will continue to monitor the deployment of our inventory, but we are currently confident the level of availability we offer is a differentiator.

Finally, I would like to provide some information on the progress of our new store growth in the first quarter. We had a very strong first quarter in terms of new store openings with a total of 65 new stores opened in the quarter. As we have discussed in previous quarters, our expanded store footprint gives us the ability to spread out our organic store growth, and our new store openings in the first quarter were balanced across the country. We are very pleased with the management teams leading these new stores and we are excited about the opportunities we are seeing as we move into new markets. We remain on track to hit our previously announced target of 190 net new stores in 2013.

As Greg previously mentioned, we converted the computer systems in the VIP stores early March. We are excited to continue to move forward with integrating this acquisition and establishing a strong O'Reilly presence in the Northeast. The transition and training has gone very smoothly so far but we are still in the early stages of rolling out our business model and it'll take a while for us to drive the results that we expect in these new markets. As always, we continue to actively look for additional bolt-on acquisitions to supplement our organic store growth but remain a patient and disciplined buyer.

Before I turn the call over to Tom, I would once again like to thank our store and distribution center teams for the great service they provide to our customers each and every day. Now I'll turn the call over to Tom.

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

Thanks, Jeff. Now I will take a closer look at our results and add some color to our guidance.

Comparable store sales for the quarter increased 0.6% on top of prior year's comps of 7.4%. Excluding the impact of Leap Day in both periods, comps were 1.9% for the first quarter of 2013 on top of 6.1% in 2012. As Greg has discussed, our first-quarter comparable store sales calendared through tough comparisons and came within our guidance expectations, March, largely impacted by the late spring weather which left us in the bottom half of our guidance range. We would view this as solely related to the timing of the initial spring business and it has not changed our guidance expectations for the full year 2013 we set in January.

For the quarter sales increased $56 million comprised of a $9 million increase in comp store sales, a $50 million increase in non-comp store sales, a $2 million decrease in non-comp, non-store sales and a $1 million decrease from closed stores. The acquired VIP stores are included in the non-comp store sales due to the significant change in the business model declassification issues with historical data. We will begin including these stores' sales in our comp base on January 1, 2014.

Gross profit for the quarter increased 59 basis points over the prior year. Our gross margin performance came in slightly better than we expected, primarily as a result of a more favorable mix and the difference in spring business between the years. As Greg previously mentioned, we are pleased with the progression of our margin on a sequential basis and we expect gross margin to trend within our previous expectations for the balance of 2013, but we are slightly raising our full-year gross margin guidance to 50% to 50.4% to flow through the mix related beat from the first quarter.

SG&A for the quarter was 34.5% of sales versus 33.6% in the prior year. First-quarter SG&A dollars were in line with our expectations and we continue to expect to see per-store SG&A increase approximately 0.5% for the full year.

Diluted earnings per share for the first quarter was $1.36 per share, which represents a 19% increase over diluted earnings per share of $1.14 in the first quarter of 2012. The first-quarter EPS benefited from a tax rate of 35.9% of pre-tax income versus a rate of 38.5% in the first quarter of 2012. This beneficial tax rate was the result of the positive results from the resolution of income tax audits and a benefit from certain job tax credits. We were able to qualify for these job tax credits earlier than expected in 2013 with a benefit to EPS of approximately $0.02 in the first quarter compared to our original guidance expectations, but we'd still expect to see a full-year tax rate of approximately 37.4% of pre-tax income.

We are updating our full-year EPS guidance to a range of $5.64 to $5.74. Our total sales guidance for the remainder of the year is unchanged, so this EPS guidance change reflects the first quarter above-plan EPS and the impact of incremental shares repurchased since we last provided guidance in our fourth-quarter call in February. For the second quarter, we are establishing diluted earnings per share guidance of $1.46 to $1.56. As a reminder, our EPS guidance for both the year and the second quarter takes into account the shares repurchased through yesterday but does not reflect the impact of any potential future share repurchases.

Moving to the balance sheet, our average inventories per store at the end of the first quarter was $568,000, up 8% from $526,000 at the end of the first quarter of 2012 but down slightly from $573,000 at the end of 2012. We continue to project inventory per store to be flat at the end of 2013 versus the end of 2012 as we continue to identify opportunities to redeploy our existing investment into more productive inventory.

Our quarter end AP inventory percentage of 85.7% was better than we expected due to the timing of inventory additions in the first few months of the year, but we still expect the ratio to be relatively flat at the end of 2013 compared to the end of 2012 as incremental improvements and vendor terms offset by the headwind from payments for the 2012 inventory build. As we move past the cash payment cycle of the 2012 inventory investments, we would continue to expect to realize gradual improvements in our AP percentage after this year.

Capital expenditures for the first quarter of $73 million were in line with our expectations and we are keeping our full-year CapEx guidance unchanged at $385 million to $415 million.

For the quarter, free cash flow declined to $153 million versus $339 million in 2012, caused solely by the dramatic improvements were made in our net inventory investment in 2012 driven by our vendor financing program. We have not changed our full-year free cash flow expectations and are maintaining our original guidance range of $450 million to $500 million

Next, I'd like to provide an update on our share repurchase program. During the first quarter, we have repurchased approximately 2.5 million shares with an aggregate cost of $228 million at an average price of $92.35, a significant majority of this buyback coming prior to our year end earnings release in early February. Subsequent to the end of the first quarter and through the date of our earnings release, we repurchased approximately 0.6 million shares at an average price of $101.21. This brings our cumulative share repurchase since the inception of our program in January of 2011 through yesterday to 35 million shares with an average price of $77.14. As we have discussed several times since the inception of our repurchase program, we continue to believe the best use of our cash is to reinvest back into our business, but we continue to see buybacks as an effective use of excess available cash and will continue to opportunistically execute the program moving forward.

Finally, I would like to provide some color around our leverage and expectations for adding incremental debt in 2013. At the end of the first-quarter our adjusted debt to adjusted EBITDA was 1.84 times, which was flat from year end and remains below our long-term target leverage range of 2 to 2.25 times. As we noted on our last call, we still expect to incrementally increase our leverage and enter our long-term range in 2013. We feel comfortable incurring debt at these levels, consistent with the leverage target we established at the beginning of 2011 but we remain very committed to maintaining and improving our investment grade rating.

At this time I would like to ask Latasha, the operator, to return the line and we will be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator instructions) Matthew Fassler, Goldman Sachs.

Matthew Fassler - *Goldman Sachs - Analyst*

The first question I want to ask -- as you think about both the normalization of some of the weather factors that impeded your business late in the first quarter and you think about the comparisons that you are cycling, the easier comparisons that you're cycling over the next several quarters, as you see the business pick back up from the low singles to mid singles or better, should that pickup come in DIY, in commercial or would it be spread evenly across the franchise?

Greg Henslee - *O'Reilly Automotive - President & CEO*

I think it will come in both. I think because a lot of the DIY customers work on their cars in their driveways and outside and so forth, that having the late spring weather that we are having this year should push some of that DIY business further into the year and then also some of that business is related to spring cleanup -- waxing cars, cleaning out the interiors and just doing some minor maintenance and so forth. So yes, we would expect a good pickup in DIY. At the same time the professional business or commercial business has been doing pretty well anyway, so we would expect that to continue to tick away as it has been.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it, and then the second question, just related to the loyalty program -- obviously, gathering that data makes a tremendous amount of sense. One of the dynamics we think about when we consider the utility of the loyalty program is frequency of shop. So what can you tell us about how many visits your DIY customer has to your store in any given year and how you think about the accumulation of points and deploying them in your store, considering that?

Greg Henslee - *O'Reilly Automotive - President & CEO*

We don't have a lot of good information on that right now, other than just different marketing surveys that we've done and so forth. But based on what we know, which again is just based on selected surveys from different markets where we've hired companies and done some of our own studies, a couple of times a year we would typically have a shop. There's a huge variation depending on the type of customer. More medium and heavy do-it-yourselfers -- you can have a lot of shops from the same customer. I remember even back in my history being in the stores, you might see the same customer two or three times a month. It's the kind of person that helps keep their family's car running and maybe has an old car that has problems. But on average, if you are taking the very light DIYers that might just come in and change wiper blades mixed with those customers a couple times a year, but with this loyalty program we are going to learn a lot more about that and be able to market to those customers to time coupons or specials that we want to push out to them to coincide with when we would expect them to need to do the kind of maintenance on their vehicles that they might be doing based on our historical purchase records.

Matthew Fassler - *Goldman Sachs - Analyst*

And just a final follow-up to that -- is that more frequent shopper, you think, shopping parts as opposed to chemicals and other consumables?

Greg Henslee - *O'Reilly Automotive - President & CEO*

Yes, more parts. They are people that work on cars. They are helping friends put on tie rod ends and change belts and hoses and stuff like that.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it, thank you so much, I appreciate that.

Operator

Michael Lasser, UBS.

Michael Lasser - *UBS - Analyst*

Matt knew all the answers to that because he's in the stores about twice a month anyway. But the question I wanted to focus on was on gross margin. You cited early in the script that the gross margin improvement came from shrink and distribution efficiencies, and then later it sounded like you may have seen some mix benefit. So can you clarify that? If it's possible, maybe you could provide a quantitative breakdown as well.

Greg Henslee - *O'Reilly Automotive - President & CEO*

Let me make a comment, and I will let Tom do the qualification part of it. Our shrink and distribution costs -- we've had some benefit from both those areas that we expect to continue to see. When I spoke to the mix difference, we are speaking to the fact that we haven't seen as much of this light maintenance stuff that you would typically have in the spring, the cleanup and maybe some oil changes and stuff like that, had a little bit of decrease in that stuff. And the thought was that some of those products, because they're promotional in nature to some degree, would carry a lighter gross margin than the hard parts business that we are driving our gross margin with currently.

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

Hey, Michael, It's Tom. What I would add to that is Greg's comments earlier in the script were focused on the year-over-year change and my comments on the mix later in the call were where we were different from where we thought we would be from a guidance standpoint. So when we look at the improvement over our guidance, it was mix related. As Greg mentioned, that shift in the type of business we did in the spring had that impact.

Michael Lasser - *UBS - Analyst*

That's very helpful. The second question is on the idea that there's a lot of pent-up demand due in part to how the weather has unfolded over the last 12 to 15 months. As you talk about seeing improved trends in April, is any of that driven by some of the replenishment categories that have gotten hit particularly hard, or is it just too early to tell?

Greg Henslee - *O'Reilly Automotive - President & CEO*

Well, it's a little too early to tell. What we are seeing right now is typical spring business where we are selling a lot of cleanup chemicals, oil changes, maintenance on things like belts and hoses that people put off. What we saw a lot of in the first quarter -- we did really good, for instance, in batteries and cooling systems, which can be more weather related. The cold weather causes cooling system issues, hot weather causes cooling system issues, as it does cause battery issues, and those categories did pretty well.

So I think what we're seeing right now is just more typical spring product demand. My speculation would be that there has got to be some pent-up demand for this spring type business that would have normally experienced by now. I know for years of being here at O'Reilly we didn't talk much about weather just because it's just the weather; there's not much you can do about it. But this is a really unusual comparison in our first quarter to a quarter last year where we had just an incredibly early spring. It was k very unusual, as I know you all know. This year, in the middle part of the country, we really have had -- we really don't have spring yet. We have had -- just up until this week there are many markets that really haven't had much of a spring yet. Even up in the upper Midwest, they are having so right now. It's an unusual comparison.

But the spring weather that we would typically have that creates the demand that we would typically expect in the spring has yet to happen in some markets, so we would expect that to be a driver of comps in the second quarter.

Michael Lasser - *UBS - Analyst*

Sounds good, best of luck in the second quarter.

Operator

Chris Horvers, JPMorgan.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

I wanted to just clarify -- I thought in the first quarter you talked about SG&A per store 1 to 1.5 for the year, and you just mentioned up 0.5. So was there a change or is there something I missed in my notes?

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

When we talked on the first quarter call, we were talking excluding VIP. This quarter we decided just to go chain-wide. The VIP stores are lower volume and lower cost based at this point.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

I got you. Following up on the previous question, we would love to hear your thoughts on what you are seeing in brakes and rotors and rotating electrical and some of the things underneath the car and how does that really illustrate or inform the situation around the debate between the industry slowing down versus the weather impacts.

Greg Henslee - *O'Reilly Automotive - President & CEO*

Well, there's a lot -- we have a lot of information on this, as you can imagine we would. When you look at our product sales by category, it's hard to form conclusions. But I can give you some information that I have and the way I look at this.

In the first quarter, for instance, batteries were really strong and I think it's directly related to the fact that we had some winter weather in a period from a comparable standpoint that we really didn't have winter weather last year. Cooling systems performed really well from a comp store sales perspective. These are things that if you have a problem with them, you have got to fix them. If your car is overheating from the cooling system failing or if your battery is shot and your car won't start, you have got to replace them. Rotating electrical did very well. Again, if your alternator or starter doesn't work and you want to drive your car, you have got to replace it.

Things that didn't do as well, for instance, from a comparison perspective are things like refrigerant. One factor there is that refrigerant costs less this year than it did last year. But from a demand standpoint it's easy to speculate that there isn't as much demand for refrigerant in a cold spring is there would be a hot spring like we had last year. So refrigerant was down. Brakes are down, and I think that's something that we hear across the industry and I think there could be several factors that affect that. But one of those is that many times when you have a brake job done, it's not because your brakes stop working. It's because the friction material, the brake pads or shoes, depending on what you are driving, wear down and you need to replace him. Many times it's identified when you are having your tires rotated or maybe your oil changed at a shop or whatever the case may be. But in most cases, the brakes are not metal to metal or the consumer would have heard that and would have had to have had the brakes replaced already. It's one of those things where the brakes have little bit left on them but do you want to replace them now.

I think that customers have been a little bit in a deferral mode and if there's some 3000 or 4000 miles left on the brakes, which is not unusual in a then brake pad situation, I think there's more customers that are choosing to drive in the first quarter, particularly, wait until they get their tax refund because we had this delayed tax refund effect. Or just tough economic conditions that would cause them to say, listen, I am going to squeeze every little bit of the brake pad out of those things.

So I would relate it more to that. Other differences we have are like in the motor oil. We had a -- didn't comp as well in motor oil as what we had been and I relate that to some heavy promotions that we had last year, but also that much of our motor oil sales is DIY and a lot of DIYers just haven't had the opportunity to be out in their driveway changing their oil as much as they would in a typical spring.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

That's very helpful. So then -- okay, got you. Finally, on the inflation side, can you talk about what the inflation experience was in this quarter and maybe versus last year and just remind us how it played out from an inflation/deflation perspective over the balance of last year in the second, third and fourth quarter?

Greg Henslee - *O'Reilly Automotive - President & CEO*

Tom, do you want to take that?

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

Let me look through my data here. So in the first quarter we would have been pretty historical norm, between 1% and 1.5%. We would expect to be there for the remainder of the year. When we look at last year, last year it was a little bit of a -- less of a help last year and was pretty consistent throughout the year.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

Consistently less of a help?

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

Correct.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

And did you have any quarter with deflation?

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

If you look at our change in our LIFO reserve, I think you'd see that small amount each quarter.

Chris Horvers - *JPMorgan Chase & Co. - Analyst*

Okay, perfect, thanks very much.

Operator

Scot Ciccarelli, RBC Capital Markets.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

It's a little bit of a follow up on Chris's question. I think we all understand weather has been a challenge, and obviously you guys have been a pretty consistent share gainer over the years. But I guess my question is the bigger picture. As new car sales continue to rise, is there any reason to believe that this industry just doesn't go back to being a 1% to 3% comp industry, which is kind of what it was before the new car sale implosion back in 2008.

Greg Henslee - *O'Reilly Automotive - President & CEO*

I think that, over time, depending on new car sales over the next few years, we are talking -- I don't know, what are we up to now, maybe a 14 million new car units expected to sell this year, maybe a little more than that. We're on a 241 million vehicle population, so it takes a few years for that to really have a big effect.

The thing I would say is that the cars that are still out there are older and that's going to continue to be the case. And I think that through the recession and through people's experience with some of the later model cars that are better engineered, there's just -- and I feel like I'm repeating myself because I know I've said this many times before. But these later model cars, and those of you that drive cars realize this, the drivetrains in these cars are solid and they can be driven at really high mileages. But that doesn't prevent all the things that the aftermarket has always been about from continuing to have to be replaced, things like brakes and chassis parts and belts and hoses and fluid changes and filters and just ignition parts, and in the future emission parts, all the sensors that feed the computer system that helps run the fuel injection and the air intake systems and all these things. But when those things have problems it's hard for a consumer to say that's a reason to get rid of the car, that's a reason to trade the car, because the engine, transmission and differential and the interior and the bodies of the cars are still in pretty good shape. Given the option of driving the car for another year or something or taking on a $400 a month car payment, they choose to drive the car. So I think there's going to be a -- I think the older vehicles on the road is going to offset for some period of time the increasing level of new car sales that we are seeing. Tom, do you have a comment?

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

What I would also add to that is we have had a number of very, very good years and high SAR years. Our focus really is less on the SAR and more on the total number of vehicles on the road and the total number of miles driven. Our expectation is as the economy improves, the SAR will improve and the number of vehicles on the road has flattened out over the last two or three years that we will get back to seeing an increased number of vehicles on the road. And as unemployment declines and people feel more confident, we are also going to see a higher employment rate and we are going to see more miles driven, which is going to be a driver of demand in our industry. So we don't look at -- we look at a rising SAR as a positive because their consumer has more money in their pocket, more people are working and we have more opportunities for our parts to wear down.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

Got it, thanks, guys.

Operator

Michael Montani, ISI Group.

Michael Montani - *ISI Group - Analyst*

The first question I had was in promotional event that you are seeing with regards to pricing power as you look across the market now. Just given some of the slowing in the first quarter, would you say still rational? And given the gross margin outlook, it looks like you're feeling pretty good about that, but I just went to get your thoughts.

Greg Henslee - *O'Reilly Automotive - President & CEO*

Yes, I think it's a very rational. I think we are all pretty good shopping each other these days, and we have seen no significant change related to the pricing strategies of our competitors. It has been some time, actually. Now, we all still continue to run promotions and our typical promotions are a variety of things. But oil changes, for instance -- there's a volley back and forth between maybe a $19.99 branded oil change and a $21.99 branded oil change, but that's been the case for some time. So what I want to tell you is there's really no change in the strategies that we have seen from either just a fixed pricing perspective or a promotional pricing perspective. We're all trying to run promotions to drive the traffic in our stores.

Michael Montani - *ISI Group - Analyst*

And then with the gross margin outlook being a little higher and EBIT margins being consistent, is there anything driving that divergence in the SG&A line, first? And then second, with Affordable Care Act coming up, we have been thinking that could be like a 70 to 80 BIP generic headwind for many retailers. Is there any way to quantify that or any numbers that you all can share in terms of things you are doing to offset it?

Tom McFall - *O'Reilly Automotive - CFO & EVP, Finance*

You take the SG&A and I'll (inaudible). On the SG&A, we have a slight increase in our margin. And as you said, the EBIT range is the same. The change in gross margin wasn't that significant to drive us to change the number of our operating profit, so I would say that's more of a potential adjustment in the range.

Greg Henslee - *O'Reilly Automotive - President & CEO*

On the Affordable Care Act, there's still a lot of things to be quantified and determined, and there's even a few things are changing like the mandatory enrollment of team members into the health plan was recently delayed from January 1 of 2014. So there's still some maybe that's yet to be seen, so it's a little bit difficult to quantify. We've engaged help from outside our Company to help us qualify and plan. Our plan is simply to do the things that we need to do to mitigate the expense. So we'll work through doing that. Part of that is just changing or incrementally making a minor change in our part-time/full-time mix, which we have been working to do anyway for some period of time. And then things we can do with our plan to help offset some of the costs that we might burden that we would not previously have burdened. But our effort will be to try and mitigate the additional costs that we would have so that it wouldn't be something that would be recognized as an additional operating expense.

Michael Montani - *ISI Group - Analyst*

Okay. So what I'm hearing is it sounds like there's things you can do to offset and actually it may not be that large of a step function for you all. Is that fair?

Greg Henslee - *O'Reilly Automotive - President & CEO*

I'm sorry; could you repeat that?

Michael Montani - *ISI Group - Analyst*

It sounds like there's initiatives that you all have underway to mitigate that, and actually the 70 to 80 VIP sort of generic number -- that could be sort of high versus what you guys think you can do.

Greg Henslee - *O'Reilly Automotive - President & CEO*

I think, if we all just said we are going to keep doing exactly what we are doing and we're just going to take this on the chin, I think that number might be pretty close, depending on the Company. There's a lot of variation between companies. My expectation would be that most companies are not going to take this without having some adjustment in what they sell products to stay whole from a profit standpoint.

Michael Montani - *ISI Group - Analyst*

Thank you and good luck.

Operator

Sam Reid, Barclays Capital.

Sam Reid - *Barclays Capital - Analyst*

We noticed that income tax return data really started to pick up at the tail end of your quarter. I'm wondering if you started to see a corresponding boost to demand during the quarter as customers started to receive their returns back. And just to add to that, if you see maybe some further benefit of that as you move into 2Q?

Greg Henslee - *O'Reilly Automotive - President & CEO*

Yes, I think there's an uneven comparison of when people typically get their tax refunds last year to this year, and it's a later. Unusual in this year is that as people have gotten these tax refunds, it has not been spring yet, even though the calendar says, they've still got snow on the ground or real cold weather. So there's a little bit of a distortion there and how we view do that.

But, yes, the expectation is, our expectation is that -- and I think we've seen this in our April comparable store sales so far because they have been pretty good and more reflective of what we would have expected to see in the spring is that there are people that have now the tax refunds and are spending money on things that they had deferred and that with spring weather, they are able to do the work that they are needing to do.

Sam Reid - *Barclays Capital - Analyst*

And then one follow-up -- any updated thoughts around your expansion in Florida? It may have been covered, but just anything that you guys have that might be incremental would be helpful.

Greg Henslee - *O'Reilly Automotive - President & CEO*

Well, we're putting stores down there. Our plan is to continue to expand down there. We feel like we were doing a good job gaining market share. We've got a really solid team down there. The distribution center, of course, underway, which is a ways away from being completed, but we have got hub operations down there and we are incrementally gaining share. And it was one of the contributors to our store growth for the quarter. I think we opened an additional five stores down there during the quarter. So we continue to grow down there and have big plans for having a significant presence in Florida over time.

Sam Reid - *Barclays Capital - Analyst*

Awesome, awesome, thank you so much for answering my question.

Operator

[Jack Bellows], [Focus Research].

Jack Bellows - *Focus Research - Analyst*

I was wondering if your technology is enabling you to perhaps better match the population of stores, of cars around the store with the inventory that you have at the store itself so that there are fewer times when someone comes to the store and you're out of the part that they are looking for?

Greg Henslee - *O'Reilly Automotive - President & CEO*

Yes, Jack, that's a big deal for us. The car population is so diverse and there is such a difference between, for instance, Seattle and Orlando or even Springfield, Missouri, where we are at, to Houston, Texas. We have a lot of four-wheel-drives here because sometimes have winter weather. In Houston, they really don't have winter weather, so while there's a lot of pickups and SUVs, most of them are two-wheel drives, and around here you have a lot more four-wheel-drives. And then you just have the brand differences, where on the coast you just tend to have more European and Asian imports whereas in the center part of the country, you have less.

So deploying inventory in our stores is completely dependent on the vehicle population that surrounds that store. That's one of the key pieces of criteria we use when we put inventory in a new store. And then as we do our ongoing adjustments of those inventories as new products become available or as demand starts to tick up, one of the key factors is how many of the cars that this part fits exist in that market. So that's something that, as computers have become completely prevalent in running our business, that we have been able to leverage technology and use databases that we buy from outside the Company to help us drive what we put in our stores and do a better job of managing our inventory.

Jack Bellows - *Focus Research - Analyst*

That's very good. The other thing I'm wondering about is e-commerce and the Internet. To what degree can your customers go to other websites and buy parts directly? And when they do that, what is the comparison in the prices they pay, compared to O'Reilly?

Greg Henslee - *O'Reilly Automotive - President & CEO*

No question, auto parts are available on the Internet. There's several websites, actually, that have access to inventory. Some of these companies stock a little inventory. Many buy from -- they have dropship agreements with warehouse distributors and others that have inventory.

Typically speaking, an e-commerce company -- and I would reference a couple, maybe like the US Auto Parts or a RockAuto or something like that, they would try to sell below us brick-and-mortar guys just because they have to do something to try and get someone to agree to wait to get a part as opposed to being able to drive a few blocks and get it.

In most markets, and I'm not talking about the rural areas because there are people who live out in rural areas where there's not a parts store. But with as many part stores in the US, there's a convenience factor here and most people live pretty near a parts store. But the Internet is lower priced than what our stores are priced and then there's the additional factor of the frustration of ordering parts that you are not sure you need and then trying to deal with returning them.

So our business is not as inclined to do a lot of volume e-commerce wise as a lot of businesses are, mainly because of those factors I mentioned and then also just the technical expertise it takes to determine what's actually wrong with the car. Many times when a customer walks in our store, they know they've got a problem and they think they know what they need, but we will end up selling them something else as result. So it's a factor but not huge factor for us.

Jack Bellows - *Focus Research - Analyst*

Very good, thank you.

Operator

We have made our allotted time for Q&A. I will now turn the call over to our host, Mr. Greg Henslee, for closing remarks.

Greg Henslee - *O'Reilly Automotive - President & CEO*

Thank you, Latasha. We would like to conclude our call today by again thanking our 56,000 members of Team O'Reilly for their commitment to providing the best customer service in our industry. It is your hard work and dedication to serving our customers that drives our success. I would also like to thank everyone on the call for their time this morning. We look forward to reporting our second-quarter results in July and we'll talk to you then. Thank you.

Operator

This will conclude today's call. You may now disconnect.
