OVERVIEW:
Co. reported full-year 2013 total sales of $6.6b and EPS of $6.03. 4Q13 diluted EPS was $1.40. Expects full-year 2014 total revenue to be $7.0-7.2b and diluted EPS to be $6.74-6.84. Expects 1Q14 diluted EPS to be $1.53-1.57.
CORPORATE PARTICIPANTS

Tom McFall O'Reilly Automotive Inc. - CFO
Greg Henslee O'Reilly Automotive Inc. - CEO
Jeff Shaw O'Reilly Automotive Inc. - EVP of Store Operations and Sales
Ted Wise O'Reilly Automotive Inc. - EVP-Expansion

CONFERENCE CALL PARTICIPANTS

Michael Lasser UBS - Analyst
Alan Rifkin Barclays Capital - Analyst
Matthew Fassler Goldman Sachs - Analyst
Scot Ciccarelli RBC Capital Markets - Analyst
Christopher Horvers JPMorgan Chase & Co. - Analyst
Bret Jordan BB&T Capital Markets - Analyst
Daniel Hofkin William Blair & Company - Analyst
Greg Melich ISI Group - Analyst

PRESENTATION

Operator

Welcome to the O'Reilly Automotive Incorporated fourth quarter and full year 2013 earnings release conference call. My name is Hilda and I will be your operator for today. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session.

I will now turn the call over to Mr. Tom McFall. Mr. McFall, you may begin.

Tom McFall - O'Reilly Automotive Inc. - CFO

Thank you, Hilda. 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, intent, 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 revenues and future performance. These forward-looking statements are based on estimates, projections, beliefs and assumptions that are not guarantees of future events and results.

Such statements are subject to risks, uncertainties and assumptions including but not limited to competition, private demand, the market for auto parts, the economy in general, inflation, consumer debt level, government regulations, the Company's increased debt levels, credit ratings on 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 Inc. - CEO

Thanks, Tom. Good morning, everyone, and welcome to the O'Reilly Auto Parts fourth quarter conference call. Participating on the call with me this morning is, of course, Tom McFall, 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.

It is my pleasure to report another quarter of industry-leading comparable-store sales results and once again congratulate Team O'Reilly on an outstanding performance as we finished up a solid 2013 with a very strong fourth quarter. Our Team's relentless focus on serving our customers and their proven ability to provide superior value and service drove our fourth quarter comparable-store sales increase of 5.4%.

These strong results were on top of last year's fourth quarter comparable-store sales increase of 4.2% and exceeded our guidance of 3% to 5%. For the full year of 2013, our Team delivered a solid 4.3% increase in comparable-store sales, which was higher than the midpoint of our guidance of 3% to 5%. This was the same guidance range we set at the beginning of 2013 and maintained throughout the year and it says a great deal about the consistent performance Team O'Reilly is able to deliver.

Driven by the solid comparable-store sales performance combined with the strong opening of 190 new stores, total sales in 2013 increased 7.6% to $6.6 billion. We are extremely focused on growing sales profitably and we are especially proud of our Team's ability to deliver robust topline growth while also improving our property profit by 79 basis points to a record 16.6% for the year.

Our Team's long-term commitment to providing consistent excellent customer service fueled EPS growth of 23% for the fourth quarter, which represents the 20th consecutive quarter we have grown adjusted earnings per share in excess of 15%. EPS for the full year grew 27% to $6.03, the fifth straight year Team O'Reilly has delivered year-over-year adjusted earnings per share growth exceeding 25%. This remarkable track record of high earnings growth over such a long period of time is a testament to the effectiveness of our dual market strategy and the unwavering commitment of Team O'Reilly to providing the best customer service in the automotive aftermarket.

Coming into the fourth quarter, we established our comparable store sales guidance range of 3% to 5% in anticipation of the continuation of a solid business trend we had seen throughout the summer. And we were pleased to deliver comparable store sales growth above that range at 5.4% as a result of the strength of the business across the chain augmented by the early and extreme cold weather in the center of the country.

As many of you know, extreme cold weather contributes to higher rates of parts failures in certain categories and generates demand in our business. And the weather patterns we saw across much of the country strengthened our performance as we progressed throughout the quarter.

The inclement weather had a more positive impact in our DIY sales performance versus the professional service provider side of our business as the cold wintry weather across the central US drove robust DIY traffic on categories such as batteries, antifreeze, and wiper blades. However, our West Coast stores actually experienced tougher year-over-year weather comparisons due to the impact of an abnormally dry 2013 conditions on wiper sales and other categories.

In total, the beneficial weather-related drivers help swing our DIY traffic counts back to positive growth for the fourth quarter.

While we are certainly pleased with our Team's ability to capitalize on the additional weather-related volume in the fourth quarter, the most significant driver of our solid comparable store sales continues to be the very strong performance in the hard parts categories on the professional side of our business.
We continue to grow our market share of the professional business with solid ticket count growth across the chain, coupled with a very robust buildout of professional business in our less mature professional markets, particularly in the western part of the country.

As we have seen for some time now, increases in average ticket have been a consistent contributor to our comparable store sales increase. We again saw an increase in average ticket in the fourth quarter, driven by continued parts complexity resulting from the better engineering of vehicles which increases average vehicle life and also requires more costly parts to repair, as well as a mix benefit as we capture professional customer market share and growth sales in hard parts categories which carry a higher average ticket. Inflation in the fourth quarter had no significant impact on our average ticket growth.

Moving on to the details of macroeconomic conditions in the fourth quarter, our comp performance benefited from stable lower gas prices and improved miles driven. Gas prices fell sequentially from an average around $3.50 per gallon in the third quarter to $3.25 in the fourth quarter and it stabilized in this area. Lower gas prices put more money in our customers’ pockets and the stable level of prices, without significant upward spikes, give consumers more confidence and positively influence demand.

Miles driven for October and November, the most recent quarters for which the data is available to us, increased approximately 1.1% and this increase results in more wear and tear on vehicles. For the full year, through November, total miles driven has increased 60 basis points and we would expect this steady positive trend to continue in the future.

As we look forward to 2014, we expect to see our solid business trends continue and we are establishing a comparable store sales guidance range of 3% to 5%. Inherent in our guidance range is an expectation we will see modest incremental improvements in employment which will drive another steady increase in miles driven and modest growth in the total vehicle population.

As it relates to the total vehicle population, while the projection is for the seasonally adjusted annual rate of new car sales to be stronger, we also expect scrap rates to remain low, based on the ability of better engineered and manufactured vehicles to stay on the road longer. As a result, we would expect a return to the trend of steady annual growth in the total vehicle population. However, even though we are expecting some improvement in the employment outlook, the level of unemployment and underemployment is still high and will continue to constrain growth in our industry.

We expect to again see growth in average transaction size in 2014, driven by continued favorable mix shifts and continued increased parts complexity. We experienced inflation 2013 which was lower than historical averages and would continue to expect lower than normal inflation in 2014, which will constrain our comparable store sales growth.

The O'Reilly specific catalysts we expect to drive our comparable store sales in 2014 include the continued buildout of our professional business in the Western US, solid incremental growth in the Northeast as our converted VIP stores gain traction, and market share gains resulting from the additional service capabilities we are adding with the opening of our Lakeland, Florida, and Chicago distribution centers as well as a host of current and planned enhancements we have to improve our service offerings.

For the first quarter of 2014, we are establishing a comp guidance range of 4% to 6% as we benefit from the sales momentum we carried out of 2013 and the continued harsh weather across much of the country. We will also realize the benefit from the calendar shift of Easter to the second quarter of 2014 versus the first quarter of 2013. Our 4% to 6% range compares to a comparable store sales increase of 0.6% in the first quarter last year. But I would remind everyone that the first quarter of 2013 faced the headwinds of the Easter calendar shift and the comparison to an extra Leap Day in 2012.

As we look past the top line in our results for the fourth quarter, gross margin was flat with the prior year, down 34 basis points sequentially from the third quarter results. These results were in line with the guidance we provided in the third quarter conference call as improved product margins resulting from decreased acquisition costs were offset by the LIFO headwinds for these cost reductions. Tom will provide a little more color regarding our LIFO accounting headwinds later in the call but I want to again stress that these charges are a short-term pressure on our gross margins while the improved acquisition costs are an ongoing benefit.
For 2014, we will again face the gross margin pressure from our LIFO accounting in the first quarter. However, as we discussed on the third quarter call, we continue to expect significant pressure to end after the first quarter and point of sale margins to remain strong all year. Industry pricing has remained rational for the last several years and we expect this to continue in 2014 and we would also not expect inflation to have a meaningful impact on our gross margins.

Based on these factors, we expect our 2014 full year guidance to be in the 50.9% to 51.4% range.

Before I turn the call over to Jeff, I want to again congratulate the 62,000 members of Team O’Reilly on another very successful year in 2013. Through your hard work and unwavering commitment to excellent customer service we continue to capture market share, generating an increase of comparable-store sales of 4.3% and we built that market share profitably, increasing operative profit by 79 basis points to an all-time high of 16.6% with earnings per share of $6.03, an increase of 27% over the prior year.

We remain confident in the long-term drivers in the automotive aftermarket and our team’s ability to continue to capture increased market share due to the execution of our proven business strategy. This confidence is reflected in our 2014 growth expectations with guidance for both operating profit of 17% to 17.4% and EPS guidance, before any additional share buybacks in 2014, of $6.74 to $6.84. We are able to set forth a strong outlook for the coming year only because of the strength of our team. And I want to take this opportunity to again thank Team O’Reilly for your contribution to our Company’s continued success.

I will now turn the call over to Jeff.

Jeff Shaw - O’Reilly Automotive Inc. - EVP of Store Operations and Sales

Thanks, Greg, and good morning, everyone. I would like to echo Greg’s comments and thank our Team Members for their hard work and dedication to providing top-notch customer service. Your commitment to building and strengthening relationships with our professional customers allowed us to continue to win share in our core hard parts business while we were also able to capitalize on the DIY opportunity presented by the early severe winter weather across much of the country to generate a robust 5.4% increase in our comparable-store sales.

Winter weather that is favorable for selling parts isn’t enough by itself to generate these sales. Our strong performance was a direct result of our store teams’ dedication to have in our stores open and ready to provide great customer service no matter how cold it got, how much snow fell, or even if they had power to the store.

The positive sales results from the extreme weather also would not be possible without our distribution teams’ dedication to ship every store nightly to replenish those high demand winter items. Our strong fourth quarter sales performance combined with solid expense control drove 68 basis points of leverage on SG&A.

For the quarter, our average per store SG&A expense increased 1%, which was in line with our expectations and reflected diligent expense control while still supporting our ability to grow market share with excellent customer service.

For the full year, we levered our SG&A by 22 basis points with an average SG&A per store increase of 68 basis points versus the prior year. The average SG&A growth was slightly above our expectations at the beginning of the year of an increase of one half of 1% per store. However, we feel we prudently managed our expenses in 2013 and in particular were very pleased with the quality of our store teams as we moved forward in 2014.

As we have discussed repeatedly in the past, we manage expenses by consistent top-notch customer service over the long term and won’t make dramatic changes to slash expenses on a quarter-to-quarter basis. You can see the result of this unwavering commitment to our customers in the quality of our parts professionals who are the absolute best in our industry at taking care of the customer. And we are more excited than ever about our team’s ability to build our business, grow market share, and open 200 successful new stores this year.

In 2014 we expect SG&A expense to grow by approximately 1.5% on a per store basis this year as we continue to invest in our team of parts professionals and the tools they need to continue to make O’Reilly the first choice of customers for their auto parts needs.
Now I would like to spend a few minutes discussing a few of our key initiatives in 2014 which will enhance or supplement the already high level of service we provide to our DIY and professional customers. It would be hard to begin any discussion of 2014 initiatives without first talking about the exciting opportunities we see with the three new distribution centers opening this year.

On January 13th, we opened our 25th distribution center in Lakeland, Florida, a 390,000 square-foot facility which is already providing daily replenishment to over 70 stores in the Florida market. We are excited about the improved same day parts availability this new DC is providing to our stores in this expansion market and are looking forward to continuing the robust new store growth and market share gains as we reach further south in Florida.

Our second planned center opening for 2014 in Naperville, Illinois, just west of Chicago, remains on track to begin servicing stores in the third quarter. Over the six-week period after the DC opening, the 360,000 square-foot facility will transition the servicing of 160 stores in the surrounding area from existing DCs, providing much more robust same-day availability to our stores in the very competitive Chicagoland market.

Lastly, our new 370,000 square-foot distribution center in Devens, Massachusetts, just west of Boston will open at the beginning of the fourth quarter and replace the [Lewiston] DC -- replace the DC in Lewiston, Maine, that we acquired in the purchase of VIP. This DC will enhance our inventory capabilities in the 56 former VIP stores by offering a wider range of SKUs and will support our future growth in the Northeast.

Our real estate teams are hard at work in the Northeast identifying and developing new store sites for openings in 2015. Instructing, stocking, and staffing over 1.1 million additional square feet of distribution capacity in one year is a huge undertaking but our distribution team has a proven track record of bringing new DCs online without a hitch. With the very successful opening of the Florida DC already under our belt, our DC teams will continue to diligently work to ensure the smooth opening of the remaining two DCs and I want to thank them for their continued dedication to providing outstanding parts availability to our customers.

In 2013 we successfully hit our target of 190 new stores, and we are very pleased with the performance of these stores which has exceeded our expectations. And we are excited about the growth opportunities in the 200 stores we will open this year. We will open stores across all of our markets in 2014, but the majority of the stores will open in Florida, California, Texas, and the upper Midwest.

A successful new store opening is truly a team effort, beginning with the identification and development of the site by our real estate group. Once a site is in the works, our store design and installation teams create a great store environment for our customers and our inventory and distribution center teams ensure we deploy an inventory mix that is tailored to meet our customers’ needs.

Finally store operations develops a great team of professional parts people to provide excellent customer service in the new store which has set O’Reilly apart in our existing markets. This teamwork has been key to our long history of profitable new store openings and will continue to be crucial to our future success, and I want to thank everyone involved in the store expansion effort.

Moving on from our store and DC expansion, I want to spend a few minutes discussing some advertising and technology initiatives we have planned for 2014. We will again have a robust advertising program in 2014 anchored by national and grassroots racing, radio spots, and college basketball’s sponsorships. Our loyalty card program was rolled out to all of our stores at the beginning of the fourth quarter and we have already signed up 4 million customers in the first four months of the program. In 2014, we will work to further our engagement with these customers through surprise and delight-targeted promotions at a local market level, tailored down to individual customer preferences based on historical purchase activity we are now collecting.

We are excited about the success of this program so far and the potential we have to improve the overall customer experience while driving increased traffic and capturing a larger percentage of our loyal customers’ business.

On the advertising front, we are also pleased to announce that O’Reilly is the official radio sponsor of Football Day [Premier’s] broadcast of the 2014 World Cup. FDP will take the exclusive official Spanish-language broadcast to their radio network of over 100 affiliates throughout the United States and O’Reilly’s relationship with this marquee event provides us outstanding exposure to a key customer demographic.
On the technology front, we will continually work to enhance the tools our team members use in our stores to provide great customer service. At any point in time, we have a multitude of initiatives underway, but two majors ones I wanted to highlight are our proprietary catalog and the new point-of-sale system.

Our catalog is a key tool for our store team members and we continually work to improve our capabilities to provide even better customer service. Enhancements in 2014 will focus on expanding product content and images, improving ease-of-use, and implementing more capabilities to access product availability in our supply network.

Finally, I want to update our progress on our new point-of-sale system. As we've discussed in the past, we are changing the process, we are in the process of changing the POS system transaction engine. The new system is much more flexible in supporting related sales efforts and dynamic targeted promotions while also making the system easier to learn and use for our parts professionals, as well as giving us the tools to quickly address business needs and future development opportunities. We are well along the way in the development process and will be piloting the new system in one store during the first quarter with chain wide rollout anticipated to begin in late summer.

However, we will not roll out this critical system until it has been thoroughly tested in a live environment in our store operations. And the information systems teams are 100% confident in our ability to make the change seamlessly.

Before I turn the call over to Tom, I would like to once again thank our store and distribution teams for their continued hard work and dedication to serving our customers. Now I will turn the call over to Tom.

Tom McFall - O'Reilly Automotive Inc. - CFO

Thanks, Jeff. I would like to start today by thanking Team O'Reily for the great finish to a very successful year. Their continued dedication to providing excellent customer service drives O'Reilly’s long-term success.

Now we will take a closer look at our results and add some color to our guidance for 2014.

Comparable-store sales for the fourth quarter increased 5.4% which exceeded our guidance of 3% to 5% and was driven by our continued solid business trends, augmented by the early onset of cold winter weather across much of the country as Greg discussed earlier. For the quarter, sales increased $133 million comprised of a $79 million increase in comp store sales, a $54 million increase in non-comp store sales, a $1 million increase in non-comp non-store sales and a $1 million decrease from closed stores.

This strong sales performance combined with our relentless focus on expense control resulted in a 23% increase in diluted earnings per share to $1.40, which exceeded the top end of our fourth quarter guidance range by $0.09.

For the year, sales increased $467 million to $6.6 billion, which was a 7.6% increase over the prior year. The increase in sales was driven by our 4.3% full year comparable-store sales growth, the addition of 190 new stores, and the 56 VIP stores acquired at the end of 2012.

As Greg previously stated, we are setting our 2014 full year comparable-store sales guidance at 3% to 5% with total revenue expected in the range of $7 billion to $7.2 billion. For the first quarter our comparable-store sales guidance was 4% to 6%.

For the fourth quarter operating profit as a percent of sales increased to 15.8% which was an 80 basis point improvement over the prior year. The key contributor to our record fourth quarter operating profit was very good leverage on store expenses from our strong comparable-store sales increase combined with solid expense control.

For the year, operating profit improved 79 basis points to a record high full year figure of 16.6% of sales. The key contributor to this increase was a 57 basis point improvement in our gross margin and leverage on our store operating expenses.

Looking forward into 2014, we are establishing our operating margin guidance at 17% to 17.4% of sales.
During the fourth quarter, we again experienced headwinds resulting from our LIFO inventory accounting. So I would like to spend a little time now providing some detail on the impact.

As we discussed on the third quarter call, we have been very successful reducing our acquisition costs over time. And as a result, during the year, we exhausted our LIFO reserve. We now are effectively valuing our inventory at the last by acquisition cost as this cost is below our historic LIFO inventory value.

In this position, each time we receive a cost decrease from our suppliers it negatively impacts our gross margin for the total flow value of the cost reduction in the period we recognize as decrease as we adjust our existing inventory on hand to the lower cost. The headwind of $14 million we experience in the fourth quarter was consistent with our original estimate and we continue to expect an additional LIFO headwind of approximately $15 million in the first quarter of 2014.

As we stated on our third quarter call and it is important to reiterate now, these negative impacts on gross margin are one-time non-cash events with a lower acquisition costs benefiting us in improved product margins going forward. We do not expect meaningful LIFO headwinds subsequent to the first quarter of 2014 and this LIFO as assumption is baked into our full year gross margin guidance in the 50.9% to 51.4% range.

With that being said, unforeseen significant acquisition cost decreases could occur and may create additional LIFO gross margin headwinds during the year.

One other item to note as it relates to our 2013 results and our expectations for 2014 is that anticipated change in our income tax rate. Our tax rate was 36.7% pretax income for the full year of 2013, a reduction from 37.8% in 2012 as a result of an increase benefit in 2013 from certain work tax credit. Based on legislation currently in place, we do not expect to realize the same level of benefits from these credits in 2014. And as such, we'll expect a higher tax rate this year. For 2014 we are expecting a tax rate of approximately 37% of pretax income.

Moving to the balance sheet, inventory per store at the end of 2013 was $570,000 versus the prior year of $573,000. These results were slightly better than the flat guidance we provided throughout the year with our strong year end sales performance providing the difference. Our ability to grow our conference store sales above 4% while keeping inventory per store flat in an environment of rapidly expanding SKU counts is a testament to the knowledge and expertise of (inaudible) of our inventory control merchandising DC teams. These groups worked tirelessly to add productive inventory to our mix, which supports our sales growth, while also keeping total inventory in check by identifying and eliminating slow moving and nonproductive SKUs and reducing inventory processing time.

In 2014 our guidance is again to keep our per store inventory flat as our teams continue to diligently add the right inventory, leverage our existing investment and minimize nonproductive inventory.

At the end of 2013, our [AP'ed] inventory was 86.6% of inventory. Representing an improvement of 190 points over the prior year. However, our year end figure was down sequentially from our third-quarter ratio of 87.8%. This decrease is consistent with our expectations as a number of large purchases from our 2012 store level additional inventory initiatives became due and payable during the fourth quarter of this year, with the remaining fluctuation due to normal cyclical nature of our business. For 2014 we expect to make incremental gains in our supplier terms and expect our APed inventory percentage to approach 90% at year-end.

Capital expenditures for 2013 were $396 million, an increase of $95 million to 2012 and near the center of the guidance range provided all year. When we look at our 2013 CapEx results we spent more than originally expected on distribution projects related to the timing of the spend of the three new DCs opening during 2014. However, we had an offsetting benefit from higher than planned mix of lease versus owned stores that opened during 2013.

For 2014 our CapEx guidance of $390 million to $420 million was an expected lower CapEx to complete our DC projects offset by higher new store CapEx. The higher new store CapEx is driven by the increase in store openings from 190 to 200 in 2014 as well as the expected higher owned versus leased mix of new store openings.
Free cash flow for 2013 was $512 million and exceeded the top end of our guidance range by $12 million primarily related to better than expected net income. For 2014, we expect free cash flow to be between $570 million and $620 million with the increase again primarily driven by expected higher net income.

Moving on to debt. We are proud to report that during the fourth quarter our credit rating was upgraded by Moody's from Baa3 to Baa2 which is now on [power] with our BBB flat rating from S&P and we remain very committed to maintaining our current investment grade ratings. With that being said, we finished 2013 with an adjusted debt to EBITDA ratio below the bottom end of our target leverage range which is 2 to 2.25 times, primarily due to our strong 2013 financial results.

We would expect additional borrowings during 2014 to move us above our current level of 1.9 times and into our targeted leverage range.

During the fourth quarter, we continued to prudently execute our share buyback program by repurchasing 2 million shares at an average cost of $124.11 per share for a total investment of $246 million. For the year, we repurchased 8.5 million shares at an average price of $109.38 for a total investment of $933 million.

We continue to believe that the best use of our cash flow and the best return for our shareholders is to invest in our business by maintaining our existing store base, opening new stores through greenfield expansion and opportunistically consolidating the industry. To the extent these opportunities do not use our available cash in 2014, we intend to continue to return capital to our shareholders by prudently executing our buyback programs.

As we announced in our release yesterday, our Board has approved an additional share repurchase authorization of $500 million bringing our current total available share authorization to $645 million available.

To recap our 2014 guidance, our first quarter comparable-store sales guidance was 4% to 6%, with full year comparable store sales guidance of 3% to 5%. For the first quarter our diluted earnings per share guidance is $1.53 to $1.57. For the full year, our diluted earnings per share guidance is $6.74 to $6.84.

As a reminder, our diluted earnings per share guidance for both the first quarter and the full year take into account the shares repurchase through our press release dated yesterday, but do not reflect the impact of any potential future share repurchases.

Finally, I would once again like to thank the entire Team O'Reilly for their continued dedication to the Company's success. Congratulations on another record-setting year.

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

Q U E S T I O N S  A N D  A N S W E R S

Operator

(Operator Instructions). Michael Lasser, UBS.

Michael Lasser - UBS - Analyst

Good morning. Thanks a lot for taking my question. First, on the industry consolidation, Greg, how are you positioning the organization to best take advantage of any business that you might be able to capitalize on?
Greg Henslee - O'Reilly Automotive Inc. - CEO

Really, Michael, we are executing the same business plan that we have always executed. We have adapted to focus on the changing vehicle population in the US, which most of the strong players in our business have. But we thought we made some solid incremental gains in that area as time has moved along. We feel like we are in real good shape right now. We also continue to look at some of the independent jobber business and or have taken on some additional independent jobbers as we moved through the last couple of quarters and we will plan to continue to do that.

And then as the consolidation that is expected to happen happens, we will do what we always do to try and drive market share gains in those markets where [U] two stores are turned into one or whatever the case may be. So really it is just kind of the same thing that we have always done and that is just try to gain as much market share in each market as we possibly can.

And we are looking at this as potential opportunity for us to maybe accelerate some of those market share gains as the consolidation happens.

Michael Lasser - UBS - Analyst

So there hasn’t been any proactive reach out to some of the independents that could be up for grabs to the extent that there’s disruption within the industry?

Greg Henslee - O'Reilly Automotive Inc. - CEO

Yes, my -- what I would say, Michael, is that anyone that sells independent jobbers in the markets where those independent jobbers that are being consolidated exist, they have been touched and talked to by everyone that distributes parts to IJs.

Michael Lasser - UBS - Analyst

Okay. Sounds a little bit like the sell side [into] the buy side, but that is something we can all relate to, I’m sure. The other question I had was on the extreme weather and how long do you expect the extreme weather that we have seen to have an influence on the industry? And in the past has there been a case where, originally, it is more of a DIY benefit and then it moves to more of a DIFM impact as cars need to be repaired from all the damage that has taken place? Thanks a lot.

Greg Henslee - O'Reilly Automotive Inc. - CEO

Well here is what I would say about weather. I think that, one, we are happy that we have had more normalized or maybe more extreme winter after having a couple of winters of not having very extreme weather. It certainly drives early demand with batteries that won’t crank the car in cold weather. Antifreeze where people didn’t have enough coolant in their cars and then wiper blades, things like that. And then as roads get damaged, as you know especially up in the Northeast and some of the real cold weather markets, that is good for us as chassis parts take a beating and you have the corrosion impacting the hub bearings and brakes and things like that.

So that is all good longer term. It really applies to both the DIY and the do-it-for-me side although the DIY is typically not a business that you get benefit from as quickly as you would the do-it-for-me side because people in many cases can’t work on their cars outside in the inclement weather.

One thing I want to say about this is that as we have these extreme temperatures, it generally is good for our business, but these winter storms and the impact of some of these storms where you just you watch the news and you see Atlanta shut down for two days they are where people just kind of hunkered down and get inside because it’s 0 degrees and below in these markets -- that is tough on cars for sure, but it sure doesn’t drive short-term demand when people are unable to get out and work on their cars and unwilling to get out and drive to repair shops and things like that.
So, I think you get some benefit from that later on in the year as people start recovering from the damage that has been done to their cars during the winter weather.

**Michael Lasser** - UBS - Analyst

Okay and just on that point, the 4% to 6%, guidance for the first quarter, that includes any disruptions that you have seen from the extreme weather as well --?

**Greg Henslee** - O'Reilly Automotive Inc. - CEO

Well, that includes everything that has happened to this point. You know it's -- when we give guidance, it is always an estimate as to what we -- where we think we will end up based on what we have experienced so far during the first it, what our comparisons are for the remainder of the period and then what our estimate is as to what the business will do during that time. But it is an estimate.

**Michael Lasser** - UBS - Analyst

Okay, thank you very much and good luck with the year.

**Greg Henslee** - O'Reilly Automotive Inc. - CEO

Thanks.

**Operator**

Alan Rifkin, Barclays.

**Alan Rifkin** - Barclays Capital - Analyst

Couple of questions, Greg. With respect to the expansion in South Florida supported by the Lakeland DC, how many of the 200 stores for 2014 will be in South Florida and how many ultimately do you think you can have in the South Florida market?

**Greg Henslee** - O'Reilly Automotive Inc. - CEO

Well, Ted, do you have the answer to how many of those will be in Florida?

**Ted Wise** - O'Reilly Automotive Inc. - EVP-Expansion

We have got 35 for sure going to be opened and then whatever comes up on short-term this year. So 35 plus this year, for sure.

**Greg Henslee** - O'Reilly Automotive Inc. - CEO

And we would estimate somewhere in the 300 area probably for total in Florida, something like that. And it is somewhat early because we still have a lot of market evaluations to do especially in the southern part of the state, but that would be an early estimate.
Okay. So, Greg, it has now been more than five years since you obviously very successfully acquired CSK and have grown that business. Is that still contributing more so to the comp? Are those former CSK stores in other words still comping above the corporate average? And what would be a good run rate on a per store basis to assume for revenues?

Well, I will answer the first part and I will let you answer the second part of that. For the year of course, CSK continues to be a positive contributor to our comp and has been -- has outcomped the remainder of the Company. But during the fourth quarter the extreme weather in the central part of the Company helped bring that back closer to, even with the core O'Reilly -- what we would call core O'Reilly stores, but really it's all of our new stores and the center and Eastern part of the country, those stores have done well. And we had a little bit of weather pressure out West with the extreme dry conditions which affect wiper blade sales which are a big business out there as well as the agriculture business there in California, which has really slowed down some with the lack of moisture.

So what we saw for the year was that CSK continues to outcomp everything else and we would expect that as we continue to grow our commercial business in that area, which we have come a long way, but we still have a long way to go. There's still a lot of competitors doing a lot of business that we would like to be doing and we are working to gain market share. We would expect that part of the country to continue to do a little better than the rest.

And then, Tom, you can answer the remainder.

And one last one if I may. What was the delta with respect to comps between markets that you would classify in the quarter as being impacted by the cold weather?

What we would tell you is that we saw better traffic in the extreme cold weather markets on the DIY side of the business driven by must-have items, batteries and electrical type of equipment. But that is about as much color as we are going to give on the difference in regions.

Okay, thank you Tom. Thank you all very much.

Okay, thank you, Alan.

Operator
Matthew Fassler, Goldman Sachs.
Matthew Fassler - Goldman Sachs - Analyst

Thanks a lot and good morning. My first question relates to thinking about the -- 2014 generally speaking, the ticket and margin implications of weather driven business to the extent that there is nice flow-through from the recent weather that lasts until the spring. What does that do to your mix and does that tend to show up solely in transactions? Transactions that is or does the ticket also tend to move with those kinds of transactions?

Greg Henslee - O'Reilly Automotive Inc. - CEO

With the type of repairs that we are talking about, where undercar pieces get damaged, right control brakes, we expect to see a higher average ticket on those. Margins on hard parts tend to be pretty good. So we would expect to continue to see an increase in average ticket in solid gross margins. And then also batteries, of course, early in the winter when the batteries fail with extreme cold. Those are a big ticket item and that positively affects our ticket average.

Matthew Fassler - Goldman Sachs - Analyst

And then by way of follow up, you have -- I think over the past year or more -- been raising your game in terms of DIY and the level of service and visible service you provide to your customers. I know that that has been an ongoing effort and perhaps it is tough to isolate its impact, but any insight on how you think that might be impacting the business would be very helpful.

Greg Henslee - O'Reilly Automotive Inc. - CEO

Well, I think it has been very positive. You know, we have allowed our store operations leaders to increase our mix of part-time team members to better service our customers on nights and weekends. And we really kind of recognize an opportunity on the professional side to better manage the spikes we have in delivery demand out to our professional customers by increasing our part-time workforce a little bit, and even our distribution centers where we have occasional spikes we have been able to use part-time people to better support things.

So we -- that has been a help, but then also just some of the services that we now provide that we were a little reluctant to a couple of years ago, I think, have been a positive contributor. I think most customers that know us look to us as a supplier that maybe has a little higher level of parts specialist in the store from a professionalism and a parts knowledge perspective and I think we have really shown them the capabilities we have now as we've started agreeing to pull check engine, light codes and do the diagnostic analysis in our stores and just do some things to help them.

In many cases those kinds of things end up with us sending a customer to one of our professional service providers that do business with us. But in either case they appreciate the help in solving their problem.

Matthew Fassler - Goldman Sachs - Analyst

Thanks so much, guys.

Operator

Scot Ciccarelli, RBC Capital Markets.

Scot Ciccarelli - RBC Capital Markets - Analyst

As you build out your presence in the Northeast and in Florida, does that change your ability to penetrate national commercial accounts or has that not really been an impediment in the past?
Greg Henslee - O'Reilly Automotive Inc. - CEO

I think we do a real good job on national accounts. I think that having a presence in every state in the country where some national accounts may have a presence improves our ability and I think we are more focused on that now than we have ever been. I think that will be an opportunity for growth for us as we continue to build out our presence in the Northeast and in South Florida.

Scot Ciccarelli - RBC Capital Markets - Analyst

And then when you -- thanks, Greg. And then when you look at the Carquest Advance combination, Carquest had some existing relationships. Advance maybe has more store coverage than what Carquest had. Does that impact your relationship at all for some of those bigger commercial accounts where Advance maybe wasn't a player beforehand?

Greg Henslee - O'Reilly Automotive Inc. - CEO

All these national accounts, there's none of them that are new to any of us. We all call on them and we are -- most of us are on their purchase list. We have -- we all have different types of relationships with them relative to rebates and where we may be on the list, but I don't think it has a big impact.

I think Carquest was pretty involved with national accounts at the point that the Advance Carquest thing took place and I think Advance has worked hard to do well in national accounts and they both had a national footprint. So, while it could have a minor impact maybe where one or the other didn't have exposure in a certain town to a national account, I would not expect it to really change the game when it comes to national accounts.

Scot Ciccarelli - RBC Capital Markets - Analyst

Got you. Thanks a lot.

Operator

Christopher Horvers, JPMorgan.

Christopher Horvers - JPMorgan Chase & Co. - Analyst

Good morning. Want to delve into LIFO. So basically, Tom, the math is you had roughly was it 90 basis points of gross margin pressure and that was roughly or actually slightly more than offset by inventory that you actually sold through that you had received better volume and better pricing on during the quarter.

Tom McFall - O'Reilly Automotive Inc. - CFO

Correct.

Christopher Horvers - JPMorgan Chase & Co. - Analyst

And so as you go forward to next year, is the math as simple as like that 90 basis points of pressure that you had in the fourth quarter ends up being sort of baseline gross margin expansion for next year in the fourth quarter?
Tom McFall - O'Reilly Automotive Inc. - CFO

Yes, you should be able to calculate the first quarter expected margin and the last three quarters of the year come up to a similar number. On a quarter by quarter basis there's some minor variations in our POS margin based on mix and advertising and DC leverage, but it is pretty consistent. Should be pretty consistent this year, excluding the first quarter.

Christopher Horvers - JPMorgan Chase & Co. - Analyst

Oh, I got you. I understand. Okay. And that is basically that this is comp or volume-driven discounts as you beget larger in spite of mixing towards the commercial side, the volume discounts that you are getting from the vendor base is overwhelming all the pressures. Or is it also supply-chain as well?

Tom McFall - O'Reilly Automotive Inc. - CFO

This year, when we look at it, it is primarily book -- we look at 2013 primarily acquisition costs and DC, primarily acquisition, when we look at 2014 our expectation is that the year-over-year increase will be from deals we have already done. We will have a little bit of pressure in our distribution costs as we opened three DCs.

Christopher Horvers - JPMorgan Chase & Co. - Analyst

Okay and then one last one as you think about the shift from Easter, is that basically 100 basis points in terms of shifting into 1Q from 2Q? And does store closure days that perhaps you've had so far quarter to date offset any of that?

Greg Henslee - O'Reilly Automotive Inc. - CEO

The Easter shift is less than that. I would say probably 40 basis points. When we look back to last year's comp at 0.6 the bigger impact was, it was a combination of that and twice as much of an impact from Leap Day in the previous year. I would expect that store closures will not be a meaningful number for us, as Jeff talked about in his call that we do everything we can to get our store opened whether it has power or whether it is running on a generator, we will transfer phones, but our job is to get those stores open and be there for customers.

Christopher Horvers - JPMorgan Chase & Co. - Analyst

Perfect. Thanks very much.

Operator

Bret Jordan, BB&T Capital Markets.

Bret Jordan - BB&T Capital Markets - Analyst

Good morning. Couple of quick questions. And one of them I guess you look at direct mix and where we ended 2013, where do you see direct mix in 2014 and sort of what the impact on gross margin expectations is there?
Tom McFall - O'Reilly Automotive Inc. - CFO

We are probably around 35% for more private label imported products including commodities. And that has a positive impact on our gross margin percentage, but from a dollar standpoint we had rather sell branded parts. But we feel like we are in a pretty good competitive position on entry-level products.

Bret Jordan - BB&T Capital Markets - Analyst

Okay and do you see that changing much in 2014 or is that sort of flatline?

Tom McFall - O'Reilly Automotive Inc. - CFO

I think we would expect to see incremental changes. You know every time we do line review we look at where we want to be positioned, what customer demand is, but we would expect to see a pretty consistent metric.

Bret Jordan - BB&T Capital Markets - Analyst

Okay. And then if we look at the Devens, Mass., DC in Q4, 33,000 to 700,000 square feet, how many stores could that serve in the northeastern market?

Greg Henslee - O'Reilly Automotive Inc. - CEO

Around 300.

Bret Jordan - BB&T Capital Markets - Analyst

Okay. And then one last question. As you pick up independent jobbers, do those revenues go into comp because they are shipped out of local store or are those shipped from DC and don’t count in comp?

Greg Henslee - O'Reilly Automotive Inc. - CEO

They are noncomp sales. They ship out of a DC, not out of a store. (multiple speakers) and they would be included on our noncomp, non-store sales.

Bret Jordan - BB&T Capital Markets - Analyst

All right, great. I appreciate it. Thank you.

Operator

Daniel Hofkin, William Blair & Company.

Daniel Hofkin - William Blair & Company - Analyst

Good morning. Just a couple of questions. First of all as it relates to traffic overall, can you characterize that? Maybe you said this earlier, but can you characterize it between DIY and DIFM in the quarter?
Tom McFall - O'Reilly Automotive Inc. - CFO

What we would say is we had a couple quarters of positive DIY and a couple of quarters that was slightly negative. Ended the year slightly negative. DIFM traffic counts have been strong all year.

Daniel Hofkin - William Blair & Company - Analyst

Okay, and thinking about guidance beyond the first quarter, you know, your first year guidance. Are you assuming that let's say second and third quarter in particular any benefit related to the cold winter?

Greg Henslee - O'Reilly Automotive Inc. - CEO

Well, I think the cold winter has been a contributor to our comps in the fourth quarter and I think that the damage that is being done to cars to some degree now should be a contributor as spring sets in and people start to clean up their cars and maintain their cars to just take care of the repairs that need to be made and to recover. So yes we would view it as a contributor. You know what would be really good is if we were having real cold weather for two weeks in a row across the country, then one week of warm weather. And we hope this summer of course turns out to be an incredibly hot summer, because extremes do drive short-term demand in our business and longer term damage to cars. So generally we see that as a positive.

Daniel Hofkin - William Blair & Company - Analyst

Okay so I mean, fair to say you are factoring in already some assumed future benefit related to the weather you have already seen.

Greg Henslee - O'Reilly Automotive Inc. - CEO

As best we can. Against our comp guidance is estimates. I know we see a lot of -- and we know the business better than anyone else, but all factors at our disposal are included in our guidance.

Daniel Hofkin - William Blair & Company - Analyst

Okay and then lastly on expansion can you talk about what is your latest thinking on Western, former CSK markets in terms of greenfields?

Greg Henslee - O'Reilly Automotive Inc. - CEO

Well, we continue to expand that there and we continue to look for sites and we plan to continue to expand that where it makes sense. A lot of our work over the next couple of years will be to evaluate potential relocations where leases come up and we may not be pleased with a site and may want to relocate it. But at the same time, we continue to look for greenfield growth. And of course California was a pretty big contributor last year to our new stores and we would expect to continue to expand that there -- out there this year.

Daniel Hofkin - William Blair & Company - Analyst

Got it. Thanks very much and best of luck.
Okay, thank you.

Operator

Greg Melich, ISI Group.

Greg Melich - ISI Group - Analyst

Thanks. Really, two questions. One starting on terms of DIY. I think you have the loyalty program. Do you have any updates how that's doing and where you are seeing traction with it and where you think you can use it more?

Greg Henslee - O'Reilly Automotive Inc. - CEO

Well, we are really happy with it, Greg. We have signed up over 4 million customers and we continue to we think benefit from the fact that we have a loyalty program and it gives us a means by which to market directly to loyal customers. So we see it as a positive. We are going to continue to build on it and we will see where it takes us. You know, it is kind of hard to quantify the positive effect of it because a lot of the business that we are doing with these loyalty customers are customers that we had before, but we feel like long term it will be good for us and certainly gives us the ability to market directly to these customers and offer them specials and incentives that we were not able to as easily before.

Greg Melich - ISI Group - Analyst

Great. And now that it is year end, I know disinflation is something you guys have talked about the last few quarters and how it has changed over the years. How 2% used to be kind of a normal number and it had come down. Where do you think we are in now on that and just given that demand environment now and the mix, do you think that we may actually start to have a little bit of reacceleration of inflation or is it still sort of a zero number in this year’s guidance?

Greg Henslee - O'Reilly Automotive Inc. - CEO

When we look at the full year it was marginally positive for 2013. We are not seeing anything right now in commodity prices or any impetus in the market to have dramatic changes in retail prices. So we are expecting a pretty muted year again for the third year in a row.

Greg Melich - ISI Group - Analyst

Great. Thanks a lot.

Operator

We have reached our allotted time for questions. I would like to turn the call over to Mr. Henslee for any closing remarks.

Greg Henslee - O'Reilly Automotive Inc. - CEO

Okay, thank you, Hilda. Well, we would like to conclude our call today by again thanking the entire O'Reilly team. We are externally proud of your hard work, dedication and your commitment and your relentless focus on providing the highest level of customer service each day resulted in
another very successful and profitable year in 2013. Each of you should be externally proud of our record-breaking results we generated during the year.

As we look ahead into 2014, we are confident in our ability to enhance our customer service with the addition of new distribution capacity and to successfully grow our market share in both new and existing markets. I would like to thank everyone for joining our call today. We are extremely proud of our record-breaking performance in 2013 and we look forward to reporting our first quarter 2014 results in April. Thank you.

Operator
Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.