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EDITED TRANSCRIPT

ORLY - Q1 2014 O’Reilly Automotive, Inc. Earnings Conference Call

EVENT DATE/TIME: APRIL 24, 2014 / 3:00PM GMT

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PRESENTATION

Operator

Welcome to the O'Reilly Automotive Inc. first-quarter earnings conference call. My name is Christine, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. Following the Company's prepared comments, we will conduct a 30-minute question-and-answer session. I will now turn the call over to Mr. Tom McFall. You may begin.

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Thank you, Christine. 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 strategy, future revenues, 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 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, 2013 for additional factors that could materially affect the Company's financial performance.

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At this time, I'd like to introduce Greg Henslee.

Greg Henslee - *O'Reilly Automotive, Inc. - President and 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, 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, is also present.

I would like to begin our call today by congratulating Team O'Reilly on another record-breaking quarter. Our team's relentless commitment to providing consistent, excellent customer service continues to drive our record-breaking results, and I would like to take this opportunity to thank each of our team members for their hard work and dedication to our Company's long-term success.

Our sales results for the first quarter exceeded our expectations, as we were able to capitalize on the strong demand generated from the harsh winter weather conditions in many of our markets. Our robust 6.3% comparable store sales increase was above the top end of our 4% to 6% guidance range and is a testament to our team's commitment to providing unsurpassed levels of customer service.

The 6.3% increase was on top of a 0.6% increase during the prior year, but I would like to remind everyone that, on an even-calendar basis, the first quarter of 2013 would have been 150 basis points higher after adjusting for the headwinds from the Easter calendar shift and the comparison to the extra Leap Day in 2012.

We estimate that our first-quarter of 2014 benefited approximately 20 basis points from the impact of the Easter shift back into the second quarter of this year, which was inherent in our guidance.

Total sales for the first quarter increased 9% to $1.7 billion, and we were especially proud of our team's ability to robustly grow our top line while also increasing our operating margin by 78 basis points to a first-quarter record of 16.6% of sales.

Our team's commitment to consistent, excellent customer service delivered EPS growth of 18.4% for the quarter, which represents our 21st consecutive quarter of adjusted earnings per share growth of 15% or greater.

As one might expect, during the first quarter the harsh winter weather conditions drove sales in our cold-weather-related categories such as batteries, rotating electrical, heating and cooling, and wiper blades. Vehicles driven on damaged roads during the quarter also benefited under-car repairs and boosted sales in categories such as ride control, chassis parts, and driveline. We believe that potholes in the roads and other wear and tear caused by the harsh went weather will result in higher levels of parts failures in the coming months.

Looking back on each of the months during the quarter, business remained relatively consistent throughout the period, although the coming of spring has been sporadic throughout our markets and did lead to some fluctuations on a weekly basis.

With the overall mix of business benefiting from the extreme winter weather, our cold-weather markets performed better than our Southern and Western markets. Our comparable store sales increase was driven equally by both our professional and DIY business. Our professional business continues to grow across all our markets, with our less mature Eastern and Western markets showing the strongest results.

The extreme weather was also a catalyst for growth in our DIY business, as our customers were forced to brave the cold to perform needed repairs to keep their vehicles on the road.

Ticket and traffic contributed equally to comparable store sales growth during the quarter. Average ticket increased in both the professional and DIY businesses, with inflation contributing very little to the growth of our comparable store sales. As we've seen over the last several years, average

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ticket growth was driven by mix as more of our sales continue to come in higher-priced hard-part categories. In addition, the increasing complexity of vehicles and improvements in the quality of component parts continues to drive up the cost of vehicle repair while stretching repair intervals.

We expect this trend will continue and will be a driver to long-term average ticket growth.

Transactions in the professional business were again positive for the quarter, and we were very pleased with the growth we saw on the DIY side, where transactions were also positive for the quarter.

As we look ahead to the second quarter, we are establishing our comparable store sales guidance at a range of 2% to 4%. The midpoint of this range represents a second-quarter two-year stack of 9.5%, which is a modest acceleration from the first-quarter two-year stack of 8.2% adjusted for the leap year comparison from 2012 and the timing of Easter, and is in line with our fourth-quarter 2013 two-year stack of 9.6%.

We expect to see a continued benefit during the second quarter from the residual effects of the very harsh winter and believe categories such as steering, suspension, and ride control will be a tailwind to spring business.

Although reported miles driven through February were down 1%, we believe this was the result of the extreme weather, and we expect miles driven to moderately increase during the year as unemployment continues to abate, contributing to increased commuter miles.

Having said that, we have seen gas prices on the rise, with year-over-year gas prices up 4% and year-to-date gas prices up over 11%. Consumers continue to be under significant economic pressure, and we believe this pressure will continue throughout 2014.

Based on our first-quarter results and our expectation of continued solid demand in our industry, we are reiterating our full-year comparable store sales guidance of a range of 3% to 5%.

For the first quarter, our gross margin improved to 50.8%, which is a 41-basis-point improvement over the first quarter of 2013. These strong results exceeded our expectations and were the result of a weather-driven mix benefit. As we discussed on prior calls, our gross margin results for the fourth quarter of 2013 and the first quarter of 2014 face significant headwinds from LIFO accounting; and Tom will provide more details on this impact in a few minutes.

However, I will say that these headwinds have largely abated, and we expect a higher quarterly gross margin for the remainder of the year. And, as such, we are reiterating our full-year gross margin guidance range of 50.9% to 51.4%. This guidance is predicated on expected continued limited inflation and rational industry pricing.

Before I turn the call over to Jeff, I would once again like to thank our more than 64,000 dedicated team members for the strong start to 2014. Through your hard work and relentless focus on providing consistent, outstanding customer service, we continue to both gain market share and profitably grow our business. We are very pleased with our record first-quarter operating margin of 16.6% and our 18.4% increase in first-quarter EPS to $1.61.

We remain very confident in the long-term drivers for demand for our industry, including an increasing rate of new vehicle sales and stable scrappage rates resulting in both a growing vehicle population as well as an aging vehicle population. Most importantly, we are extremely confident in our team's ability to consistently execute our proven dual-market strategy and gain market share.

Based on these factors and our strong first-quarter results, we are increasing our full-year EPS guidance to a range of $6.82 to $6.92. This range includes share repurchases through yesterday and excludes any potential additional share repurchases.

I would again like to thank Team O'Reilly for our very strong start to 2014. And with that, I'll turn the call over to Jeff Shaw.

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

Thanks, Greg, and good morning, everyone. I, too, would like to begin today by thanking Team O'Reilly for our outstanding first-quarter results. As I've said many times in the past, consistent, top-notch customer service is the key to our long-term success. And our team members have once again proven that dedication to helping every customer who calls or walks in our stores yields strong top-line results as well as profitable growth. Our team's high level of dedication was more apparent than ever this past quarter as our team members battled the elements to keep our stores open and take care of our customers.

As Greg mentioned earlier, the extreme winter weather we experienced drove very strong demand for our products. But without our team members' efforts to keep our stores open and being there for our customers, we wouldn't have been able to capitalize on this strong demand. To put it in perspective, the winter conditions forced us to close 247 stores for some portion of a day during the quarter. This only represents an insignificant 1/10 of 1% of our store days for the quarter. What isn't insignificant is the lasting goodwill earned from customers when you are the only parts store in town open to take care of their needs.

The harsh weather also forced two of our DCs to cancel some nightly deliveries. But because of the robust tiered distribution network we built over the years and the hard work and dedication of our DC teams, we were able to provide all of our stores with the access to the inventory needed to take care of our customers. I can't say enough about how proud we are of the way our team pulled together to overcome adversity and satisfy our customers' needs. As much as I'd like to continue to boast about our team members, I guess I should move on and provide some color on our operational results.

Taking a look at SG&A as a percentage of sales for the quarter, we levered 37 basis points due to our very strong comp performance. However, average SG&A per store increased 3.2% for the quarter, which was higher than we expected. The harsh winter weather negatively impacted our SG&A spend on many line items during the quarter, including expenses for snowplowing, additional supplies, higher utilities, and increased payroll. The higher-than-planned payroll was the result of increased commissions on our strong sales performance as well as additional hours needed to deal with the extreme weather conditions.

While our average per-store SG&A was higher than we planned, we are happy with our ability to continue to control expenses during a period of very high demand. We feel we have our stores staffed at the appropriate levels to control costs while also, and most importantly, staffed to provide consistent, unsurpassed levels of customer service. And so for the year, we continue to expect average SG&A per store to increase by approximately [1.5%].

Now I'd like to take a few minutes to update you on the progress of our distribution network expansion. As we mentioned on our fourth-quarter call, our newest distribution center opened in Lakeland, Florida, in early January has ramped up extremely well and is now providing nightly inventory replenishment to 76 stores. As it is with all new Greenfield DCs, it will take time for Lakeland build the critical mass of stores necessary to operate at maximum efficiency. Having said that, we are very pleased with the Florida DC team's productivity, and we're excited about the enhanced service levels we can now offer customers in our growing base of Florida stores.

It's been a cold and snowy winter in Massachusetts and Illinois, but our two additional DC expansion projects are also progressing nicely. Our new facility in Naperville, Illinois, just west of Chicago, is slated to begin servicing stores in the fall. And our new facility in Devens, Massachusetts, just west of Boston, will open and begin servicing stores in the fourth quarter of this year.

As a reminder, then Naperville DC is a Greenfield facility and is needed to better penetrate the large and competitive Chicago land market, which is currently serviced out of our Indianapolis DC. When our DC opens in Devens, we will relocate all of the operations from our existing DC in Lewiston, Maine, to this new facility. The larger state-of-the-art DC in Devens will give us the capacity needed to begin expanding our store base and growing our market share in the upper Northeast beginning in 2015.

Our DC teams have a long and proven track record of successfully executing multiple DC projects at the same time. And with the dedication and support of our experienced and knowledgeable DC operations team members, our 2014 DC expansion is moving along as planned.

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Now I'd like to spend some time talking about our store expansion during the quarter and our plans for the remainder of the year. In the first quarter, we opened 50 net new stores, which was just shy of our planned openings for the period. Not surprisingly, the harsh winter weather disrupted construction on many of our store projects and played the main role in the delay of some openings.

The good news is that most of our markets have broken out of the grip of winter, and we've been able to get most of our projects moving forward again.

We expect to be close to our planned store openings by the end of the second quarter, and we continue to be confident in our ability and original plan to open 200 net new stores for the year. As we discussed on our fourth-quarter call, we will open stores all across the country this year. And, in fact, during the first quarter, we opened stores in 23 different states.

Our coast-to-coast footprint allows us to be very selective in new-store site selection and, more importantly, allows us to develop and train great teams of professional parts people who are ready to provide top-notch customer service from day one. This diverse growth profile, which allows us to leverage our entire market area for new-store development, is vital to the success of our new-store openings, and we continue to be very pleased with the performance of our store openings over the past several years.

Before I finish up today, I'd like to once again thank our store and distribution teams for providing consistent, top-notch service to all of our customers each and every day. Your hard work and dedication continue to drive our profitable record-breaking results.

I'll now turn the call over to Tom.

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Thanks, Jeff. I'd like to start today by thinking Team O'Reilly for continued dedication to providing excellent customer service. Your hard work generated outstanding results in the first quarter and has us off to a strong start for 2014.

Now we'll take a closer look at our results and provide updates to our guidance. Comparable store sales for the first quarter increased 6.3%, which exceeded our guidance of 4% to 6% and was driven by our continued solid business trends in the harsh winter weather, as Greg discussed earlier.

For the quarter, sales increased $143 million, comprised of a $99 million increase in comp store sales, a $46 million increase in non-comp store sales, a $1 million decrease in non-comp (inaudible) store sales, and a $1 million decrease from closed stores. This strong sales performance, combined with our relentless focus on expense control, resulted in an 18% increase in diluted earnings per share to $1.61, which exceeded the top end of our first-quarter guidance range by $0.04.

I'd like to spend a little bit of time now providing some detail on the LIFO impact in the first quarter. As we discussed in our last two calls, our success at reducing our acquisition costs over time has exhausted our LIFO reserve, with the result that additional cost decreases create one-time, non-cash headwinds to our gross margins as we adjust our existing inventory on hand for the lower costs.

We experienced a headwind of $23 million related to this item in the first quarter, which was higher than our expectations from our fourth-quarter call due to better-than-planned cost decreases. However, this higher-than-expected LIFO headwind was offset by a mix benefit resulting in a gross margin of 50.8%, which was within our range of expectations. We do not expect meaningful LIFO headwinds for the remainder of 2014; however, unforeseen significant acquisition cost decreases could occur and may create additional gross margin headwinds during the year.

Moving to the balance sheet, inventory per store at the end of the first quarter was $569,000 versus the prior-year of $568,000, which was in line with our expectations for the first quarter. We continue to expect inventory per store to be flat for the full year as our teams diligently add the right inventory, leverage our existing investment, and minimize non-productive inventory. At the end of the first quarter, our AP'd inventory shows 90%, representing a sequential improvement of 3% from the end of 2013.

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This improvement was a result of our better-than-expected first-quarter sales and the resulting higher churn of inventory. Since we believe most of the first quarter of improvement is related to this timing benefit, we are maintaining our AP'd inventory target of approximately 90% for the end of 2014.

Capital expenditures for the first quarter were $83 million, and we still expect our full-year CapEx to be within the range of $390 million to $420 million. This leads us to free cash flow for the quarter, which was $262 million. We are revising our full-year guidance for free cash flow to $580 million to $620 million, reflecting an increase at the bottom end of our range from $570 million as result of the strong operating income results in the first quarter.

Moving on to debt, we finished the first quarter with an adjusted debt to EBITDA ratio of 1.86 times. We continue to believe our targeted leverage range of 2 to 2.25 times reflects our optimal capital structure, and we'll move into this range when the timing is appropriate.

We also continue to execute our share repurchase program, and year to date we've repurchased 0.4 million shares of our stock at an average cost of $145.94 per share for a total investment of $56 million. We continue to view our buyback program as effective means of returning available cash to shareholders after we take advantage of the opportunities to invest our business at a higher rate of return. And we will prudently execute our buyback program with an emphasis on maximizing long-term returns for our shareholders.

For the second quarter, we're establishing diluted earnings per share guidance of $1.79 to $1.83. Based on our above-plan results in the first quarter and additional shares repurchased since our last call, for the full-year we are raising our guidance from $6.74 to $6.84 per share to a range of $6.82 to $6.92 per share. As a reminder, our diluted earnings per share guidance for both the second quarter and full year take into account the shares repurchased through yesterday but do not reflect the impact of any potential future share repurchases.

Finally, I'd once again like to thank the entire O'Reilly team for their continued dedication to the Company's success. Congratulations on a great start to2014.

This concludes our prepared comments. At this time, I'd like to ask Christine, the operator, to return to the line. And we will be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Scot Ciccarelli, RBC.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

A question on the gross margin. Given Tom's commentary on the LIFO impact, it looks like gross margins would increase by 170 basis points year over year. And I guess what I'm trying to figure out is how much of that is just from the lower procurement costs that we've been discussing? And then how much of that was from mix? In other words, kind of what is sustainable, and what might be more temporary just because of the mix impact?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Tom, do you want to take that?

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Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Yes, I think if you look at our guidance for the remainder of the year, you can calculate what we think the run rate is. The bigger piece was obviously LIFO, but we did see a benefit from the winter mix of products that we sold.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

To be fair, you guys tend to be a little conservative in your gross margin outlook. So I guess, again, just looking at the increase that we saw, would you call it kind of a 50-50 split between mix and kind of procurement costs?

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

I think if you push the math, you'll find that it's a bigger procurement, and mix is more an offset to the higher-than-expected LIFO number. But we are comfortable with our guidance for the remainder of the year. And gross margin is an item that is influenced by a lot of external factors. So we think that the -- given the current business situation, the margin range we've given is appropriate.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

More than fair. Thanks, guys.

Operator

Matthew Fassler, Goldman Sachs.

Matthew Fassler - *Goldman Sachs - Analyst*

My first question relates to the buyback. Totally hear you on the leverage target and on the long-term goals. This quarter did mark a bit of a change in cadence from the time that you had started the buyback in earnest. I just want to understand the factors that influenced the timing of buybacks and whether this quarter represents any sort of directional change in terms of the velocity with which you expect to be in the market?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Well, it certainly doesn't indicate any directional change. You know, as Tom said in his prepared comments, we first look for opportunities to invest in our business. And then, from a long-term perspective, going to continue to buy back shares as is appropriate. But nothing has changed. Tom, I don't know if you have any additional comments on that.

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Definitely agree with that comment from a long-term perspective. On the short-term basis, we have a very short open window because of the year-end close time to adjust our grids, and I think that that's also a factor in the amount of shares that we bought this quarter.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. And then just a quick follow-up. For the past several quarters, I think the industry has been battling fading inflation, to put it mildly, if not perhaps a little bit of deflation. At least one of your competitors talked about some stabilization in terms of material drivers of pricing. Just curious

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as you think forward over the next year or two and contrast the environment that you've had for the past few quarters, do you see any change in direction there?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

You know, I would say that as an industry is -- raw materials need to increase in price. At least some of them; oils and resins and things like that, that we will start to see more of an inflationary cycle again. But right now, we're not seeing much of that, but we would expect to some in the future. Tom, I don't know if you have (inaudible).

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Our guidance is -- for the remainder of the year is based on continuing to see below historical average rates of inflation.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. Thank you so much, guys.

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Thanks, Matt.

Operator

Dan Wewer, Raymond James.

Dan Wewer - *Raymond James & Associates - Analyst*

Greg, I have one long-term question and one short-term question. First long-term, gross margin rate for O'Reilly is up 900 basis points over the last decade; your competitors have achieved similar improvements. If you were to go back and read the Company's forecast, say, from a few years ago, you were indicating minimal margin improvements ahead due to the growing sales contribution from commercial. And now in hindsight, that clearly was extremely conservative.

What do you think that we've got wrong on this margin expansion piece? Why is it so much more robust than what we were expecting a couple of years ago? Is it procurement costs that Tom was alluding to a second ago?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Well, I think it's a combination of two things. I think it's procurement costs. I think it's the fact that as our Company has grown and some of our larger competitors have grown, we've been able to take more advantage of some of the import products that we can bring across the sea; and large containers and take advantage of supply chain efficiencies, which help us with our gross margin. It's also just rational pricing in the marketplace.

You know, I think that most of the players in the industry realize that our business is a service business and that it's hard to win repeat customers, especially on the professional side of the business, with price as a result of great service. So I think that, as an industry, we've been very rationally priced. And I think that's been maybe a little bit more of a tailwind than we would have foreseen a few years ago.

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Dan Wewer - *Raymond James & Associates - Analyst*

When you think out the next three years, would you expect margin to continue to increasing, knowing that your commercial mix is going to further increase?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

I would certainly not expect the kind of increases we've had over the past few years. We've got a great team of people here that work every day on making sure that we are price competitive on the street and making sure we do all we can to maximize our gross margin and maintain our customer service levels. But I think we've gotten to a point where there's just not much -- there is really no low-hanging fruit left, and we are working to maintain and incrementally grow our gross margins at a slow rate. But I certainly would not expect the kind of improvements that we've seen over the past few years.

Dan Wewer - *Raymond James & Associates - Analyst*

Well, I think you all said the same thing in 2011. My other question, more short-term, talking about the weather benefits -- and you talked about the -- this continuing through the second quarter as the under-car damage begins to benefit sales. Does this exhaust itself at the end of the second quarter, or are you thinking that the deferred maintenance and repairs over the last two years have built up so much that this is going to spark good sales during the second half of the year as well?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

I think part of this depends on the condition of our customers economically. A lot of the things that are damaged in harsh weather like we had in the winter are failures that you have to fix immediately. If your battery is shot or your starter or alternator doesn't work, if you want to drive your car you've got to fix it right away. If your axle shaft CV joint starts making noise because it's been through some abuse, maybe a boot got torn and it's leaked the grease out of it, you could drive it making noise for quite some period of time.

And so I would say some people, if they're in good shape economically, will get their car fixed as soon as they start hearing the racket. Other customers will drive it through the summer, maybe even into winter before -- and then not fix it until it actually has to be fixed.

So these harsh conditions are generally good for our industry, both short term and longer term. And when I say harsh conditions, I mean weather extremes in the winter and weather extremes in the summer. What would be ideal for us is on the tail of this really harsh winter is to have a blistering hot summer driving cooling system and air conditioning and all the other type failures you can have in addition to more battery business. The battery business has been good, I think, for the whole industry this winter. And your batteries get really damaged in the extreme heat, and many times you see some failure in the winter. So a real hot summer this summer would be helpful for that also.

Dan Wewer - *Raymond James & Associates - Analyst*

Great. Thank you, and good luck.

Operator

Gary Balter, Credit Suisse.

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Gary Balter - *Credit Suisse - Analyst*

Thank you. Just a couple of questions. California has been more in a drought; like they are almost the opposite of what's going on in the other markets right now. Has that had an impact? Is that one of your weaker markets at the current time?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

To some degree it is, Gary. Categories like wiper blades and stuff like that in California have not been as strong as they have been especially on the DIY side out there. Our DIY business out there -- because a lot of the kind of things you sell to the DIY are things like wiper blades and stuff like that that are directly heat related. It has been a little bit of a drag on our business on the West Coast.

Gary Balter - *Credit Suisse - Analyst*

So how many -- do you want to quantify the drag?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

I'd rather not (laughter).

Gary Balter - *Credit Suisse - Analyst*

Just thought I'd ask you.

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

We try to stay away from as much regional information as we can just from a competitive standpoint.

Gary Balter - *Credit Suisse - Analyst*

And then -- well, my second question is also regional. You mentioned Florida in your expansion already in the distribution center. What's the size -- like, what's the potential in that market? How many stores are you looking at?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

It's yet to be determined, but we could potentially have somewhere in the area of 300 stores in Florida. So far, our new stores startups in Florida have done incredibly well, and we are very encouraged by our performance down there. And if you asked us two years ago how we thought we would start in Florida, we would've undershot how we've actually performed. So I think we're a little -- we're more optimistic now than ever about our ability to be successful in Florida.

Gary Balter - *Credit Suisse - Analyst*

And you haven't -- where are you down to in Florida?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

We are down south of Tampa now. Our DC is in Lakeland there between Tampa and Orlando. And we are south of Tampa now.

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Gary Balter - *Credit Suisse - Analyst*

Okay. And then you are working your way all the way down to, like, Miami and the Keys?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Yes. We are looking at properties now in the northern -- north side of Miami. We're not down in Miami, but we're looking at properties in the north side of Miami.

Gary Balter - *Credit Suisse - Analyst*

Okay. And actually, I'll let somebody else ask. Thank you very much.

Operator

Alan Rifkin, Barclays.

Alan Rifkin - *Barclays Capital - Analyst*

Thank you very much. Greg, the DC openings slated for all of 2014, the three of them, really mark the most concentrated effort since the very early days after the CSK acquisition when you were opening up DCs to support those 1300 stores back then. Would it be reasonable to expect that the drag on margins from these three DCs would be similar in duration as to what we saw back in the early days following CSK?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

There are some differences. When we opened the CSK DCs, we had a lot of underperforming stores that we immediately kind of rolled into those distribution centers. In this case, we have a -- we opened the DC that took stores from a distribution center that was way over its max to generate the best efficiency it can generate there in Atlanta.

Our Chicago DC is kind of the same thing. We will put several stores on it as quick as we can once it opens to relieve some of the stores that we have in an overcapacity state. They are in Indianapolis and in Minneapolis. And then in Devens, of course, it's to fund our expansion in the Northeast. And 56 stores that we bought as part of the IP will immediately start being serviced by that DC through the closure of our Lewiston DC.

So it's similar but it's different in some ways. Our distribution team does a fantastic job ramping our -- the costs that we can control through payroll and productivity up to match the number of stores that we service. So we would not expect a noticeable hit to our gross margin as a result of these openings.

Alan Rifkin - *Barclays Capital - Analyst*

Okay, thank you and --

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Alan, Tom wants to add something to that.

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Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Two items I would add to that. When we look at the CSK transition, those stores were going from one-night-a-week delivery to five. The stores are already on five-night-a-week delivery, so we have freight savings because of proximity.

And the other item that I would add is from a proportion basis, this is three into a bigger proportion. So the impact would be less dilutive. So we aren't expecting a really meaningful impact on our gross margin.

Alan Rifkin - *Barclays Capital - Analyst*

Okay, that makes a lot of sense. And one follow-up if I may. Greg, the number of categories that you mentioned that should benefit going forward from the harsh winter -- that of the undercarriage, the chassis, and the steering suspension and things like that -- collectively, approximately what percent of your revenues do those categories represent?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Well, it depends on what you, of course, include in the things that would be affected. There are a lot of things that would be affected by harsh weather including electrical, starters and alternators, batteries, driveline, ride control, steering suspension, all of that. Those are the kind of the core part of our car parts business, absent the things that would be placed to service drivability issues like emission, ignition, fuel, things like that. I really don't have a percentage. It would be -- it's at least -- if you include brakes, it would be more than half of our car parts categories for sure.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. Thank you very much. Good luck going forward.

Operator

Chris Horvers, JPMorgan.

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

If I recall last year, I think April really started to rebound for the industry with categories like brakes starting to come back industrywide. Obviously, you guys are doing a lot better. So it would seem like the comp stacks that you are referring to are actually accelerating here in April on average. So just curious how your brake business is doing as we start to lap the step up. And is it a fair comment to say that the stacks have accelerated in April, and is sort of the outlook more prudent or is there something else that's providing you with caution?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

The way we stack in our comparison from the quarter we are in to 2013 is that April would be a slightly stronger comparison than June. We kind of -- business last year in the second quarter kind of ramped down a little bit.

Yes, brakes are doing good. This time of year, brakes generally do well from a comparison standpoint. We are happy with our brake performance as it exists today. How we do through the rest of the quarter is yet to be seen, but we would expect our brake business to be good through the second quarter.

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Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Chris, this is Tom. What I would remind everyone is that when we talk about the strength of our business, we look at a dollar performance per week, and look at those dollars and do the math to see what comp they generate. So we'd [given] a 2% to 4% guidance because we have tough comparisons. That said, we are still performing on a total dollar basis strong as we have been, but that flushes out our comp range.

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

So you're saying if you sort of -- whatever you are doing on a per-weekly basis year to year and you project that out that that would put you into a 2% to 4% for the quarter?

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

It would put us into the range that we've given, yes.

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

Okay. That's in spite of the comparisons being a little easier in May and June.

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Like Tom said, we do kind of a -- we do kind of -- we do a plan, a weekly plan, for the whole year. And our weekly plan based on the comparisons we have in the second quarter would yield what we think would be somewhere in the area of a 2% to 4% comp for the second quarter.

Now, what's unknown about this is the real effect that the harsh winter we had will have during the second quarter. It's hard to know. There are a lot of factors. It's the harshest winter we've had in a long time. Gas prices are up a little bit. Unemployment is improving a little bit. So it's yet to be seen, but we feel good about the business; yet, we felt it would be imprudent for us to make our two-year stack acceleration greater than we did with the guidance we gave at 2% to 4%.

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

Totally understand. And then longer term, Greg, the great debate out here is average age or I think, more importantly, the [SAR cliff] as you look to 2015 and lapping that 2009 class of 10 million vehicles sold and the trough of this cycle. So I'm just curious if -- give you the opportunity to talk about how you think about facing that SAR cliff and cars going into that six-year-old class versus the cars exiting that 10- to 11-year-old class, which is the sort of end of the proverbial historical peak repair years.

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Sure. Well, I have read a lot of the information that many of the analysts have written about this. And we do a lot of analysis inside of our industry also. Some of our suppliers and so forth do a lot of work on this. There's no question that the data is what it is relative to the 6- to 12-year-old vehicles; the total count of those vehicles decreasing in the coming years as a result of the lower car sales back in 2010 and during the recession and so forth.

The unknown factor and kind of the comments I've made in the past have been that we feel like the way cars have been built for many years now, even back into the 90s but for sure in 2000, that they are just going to stay on the road longer. And they are more drivable at higher mileages.

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I had lunch with one of our good customers yesterday, and we were talking about this very subject. And he works on cars every day. And he knows nothing about vehicle population and this SAR cliff and all of this kind of stuff. He's just out there trying to make sure he keeps all of his techs busy and drives his business every day. And he made the comment, he said it's amazing how many miles cars have on them today. And people are still willing to invest big money in keeping them on the road because the engines and transmissions and the interiors and the bodies and all those things still are in good condition at 200,000 plus.

It sounds crazy to say this, but there are cars being driven that look pretty darn good going down the road that have over 300,000 miles on them. And the engines, transmissions are still functioning properly.

So I think that our -- those that feel that this SAR cliff is going to hurt demand significantly are discounting the fact that these vehicles that are past 12 years old are still on the road and still being maintained. And unless we see a decrease in the vehicle population in general, which would not be expected, that this is going to have a minimal impact on our industry.

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

Perfect. Thanks very much.

Operator

Michael Lasser, UBS.

Michael Lasser - *UBS - Analyst*

As you look out over the intermediate term, Greg, what are the chances that all of these harsh conditions and the cold weather have simply pulled forward demand; where the vehicle population has seen upgrades to some of the car parts, all of the parts that you mentioned, and now there won't be a need to replace some of those items for a period of time?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Well, I mean, Michael, there's always -- when a, let's say a steering part, a tie rod end, or a control arm or (inaudible) center link or a suspension part like a control arm or a ball joint or something like that that fails because of potholes and bad weather, it was going to fail at some point. It was a matter of time.

Some of the things that happened relative to sub-zero temperatures that drives belt failures and stuff like that, that belt may have lasted a long time if it had been driven at a perfect temperature for its whole life. But extremes drive demand. But in some cases, it creates demand earlier than the part typically would have failed. Sometimes it's just demand that was going to happen at that point in time anyway. So it's really hard to speculate on that, Michael.

We -- I feel like we -- as an industry, we've started talking about weather a lot the last couple of years when for most of my career we just didn't talk about it. I remember back when David was CEO, we never talked about weather. And he kind of made it his policy that the weather is the weather and we really can't do much about it, so we're just going to sell as many parts as we can.

Really that's kind of what we do today. Our operations guys, they don't look at weather forecasts to staff stores unless it's a major storm that shuts everything down and stuff like that. So demand for auto parts is really driven by miles driven, specifically in cars that are out of warranty; and, sure, you can pull demand a little bit forward in real harsh conditions that eventually it comes around.

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Michael Lasser - *UBS - Analyst*

Okay. My second question is on the AP to inventory ratio. There's a precedent in the industry to show that it can go north of 100%; in fact, it can go north of 110%. Are there any structural factors that are unique to O'Reilly that would prevent it from reaching the level of -- the best-in-class level of the peer group?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Yes. That factor is that we carry several lines of products that are products preferred by the professional customers. And that mix of business is not going to allow us to get to where some of our competitors are. Simply because these -- the vendors that carry these products are less likely to give us the terms that we would ideally want without offering them to everyone in the industry, more the traditional side of the aftermarket to which they're -- to whom they are not offering these terms. And for that reason, we are going to be a little bit more limited than what some of our more retail-based competitors are.

Michael Lasser - *UBS - Analyst*

And have you been surprised at how good the terms you've gotten already have been?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

No, we fully expected what we got. And so we're happy with where we have gotten to. But we're not -- I mean, we're not surprised. We worked hard to get it. We know exactly how it happened. And our factoring program being what it is has helped our vendors be in a position to where they could give us the terms that they've given us. But we're getting to a point where it's going to be hard to grow it a lot past where we are at today.

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Michael, this is Tom. I think the one thing that has surprised us is since January 2011, when we went to an unsecured structure and could offer this vendor financing program, the rate at which we got to a number that we thought we could get to has been a little surprising. The total isn't surprising; we just thought it would take longer.

Michael Lasser - *UBS - Analyst*

Okay. Thank you very much.

Operator

Daniel Hofkin, William Blair & Company.

Daniel Hofkin - *William Blair & Company - Analyst*

Very nice quarter. I just wanted to -- at the risk of beating the guidance topic to death, just to maybe finishing encapsulating it, is it fair to say that you guys basically set your guidance, in this case, really before the winter weather was in effect including for the second quarter? And so while maybe did see some weather benefit thus far in the quarter, your guidance for the remainder of the quarter does not explicitly incorporate an ongoing weather benefit, and so if you saw that it could theoretically be additive?

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Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

We talked about this last week and decided for sure what our guidance was going to be. So it wasn't something that was preplanned as part of our 2014 planning. You know, our two -- if you take Easter out of the equation, because Easter leveled out with the Easter being in the first quarter in 2013 and being the second quarter in 2014, and you just look at the adjustment for Leap Day, which you have to make, our first-quarter two-year stack is 8.2%. And at the midpoint of our guidance for the second quarter, our two-year stack is 9.5%. So we feel like that's reasonable guidance.

What happens in the next two months as we work through the second quarter is yet to be seen. We have every reason to think that business will continue to be good, but we have tough compares. So we'll see. But to answer your question specifically, this was not guidance that was planned early or before the end of last year; it's guidance we talked about recently.

Daniel Hofkin - *William Blair & Company - Analyst*

Okay. So there's some assumption implicit in there perhaps about weather. It's not -- it wasn't set six months ago, it's kind of a recently updated number?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

We talked about it last week. Yes.

Daniel Hofkin - *William Blair & Company - Analyst*

Okay. The other question -- I guess just back to kind of the relatively more balanced performance between professional and DIY in the last several quarters, how much more opportunity do you think there is to sort of up your game, as it seems like you have, on the DIY side of the business through whether it's more parts availability in the store; you know, higher in stock. Some of the customer service and POS initiatives? How much more room is there to go on that?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Well, Dan, I think there's always a lot of opportunity there. The DIY business is a -- they come in our store because we have professional parts people in our store, we have great inventory, and we give great service.

And some of the things that we do today that we didn't do two or three years ago or four years ago relative to helping customers with diagnostics when their check engine light is on, help install wiper blades or battery or things like that or things that -- they kind of ramp. Word gets around. We're not big advertisers of those kinds of things just with respect to our professional customers.

So these are things that build over time. Word of mouth helps drive DIY customers into our stores for those types of services. So we would expect to continue to see benefit from great customer service for a long time to come. Because we consider all of these things just kind of rolled up into the level of service that we try to offer and make sure that the level of service we offer exceeds that of most of our competitors.

So we would expect to continue to see benefit from the things that we do for some period of time. And every -- there's not a month that goes by that we don't consider things we can do to improve that through our point-of-sale system, our electronic catalog, things we're doing with our website and mobile e-commerce; things that we feel like will help tie our customers more directly to us. Our rewards program, which now has 5.5 million customers enrolled, and just all of those things.

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Daniel Hofkin - *William Blair & Company - Analyst*

Great. Well, best of luck.

Operator

Mike Baker, Deutsche Bank.

Mike Baker - *Deutsche Bank - Analyst*

Thanks, guys. I wanted to ask about the West Coast stores. Can you give us some sense as to where those former CSK stores are in terms of their mix, DIY versus DIFM, and where they ultimately can get to? And then if you could put that together total Company, what's the percent of DIFM now versus DIY? Thanks.

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

We're looking here, just a second. Do you have the numbers, Tom?

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

We're -- at the end of CSK, we're about 35% professional business; total Company is around 46%. As we talked about in the past, new stores bring on the DIY business faster than the do-it-for-me.

Mike Baker - *Deutsche Bank - Analyst*

Okay. So that 35% is CSK. I think you said in the past that that probably won't get to the 50-50 that the legacy O'Reilly stores did. Is that still the right way to think about it? And ultimately where can it get to? Is 40-60 the right kind of range, or could it be higher than that?

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

Let me go back for a second and correct my number. Consolidated professional is 42.

Mike Baker - *Deutsche Bank - Analyst*

Okay. And so what could CSK ultimately get to?

Tom McFall - *O'Reilly Automotive, Inc. - EVP of Finance and CFO*

I'll turn that went over to Greg.

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

I'm sorry, what was the -- we were -- I was flipping through the numbers here.

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Mike Baker - *Deutsche Bank - Analyst*

So CSK at 35% commercial; I think you said in the past that it likely won't get to the 50-50 that legacy O'Reilly stores were. Or at least that's what you said when you made the acquisition. But I'm wondering if that's changed or the thought process there -- or really the simple question is what can the percent of DIFM ultimately get to in the CSK stores?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

We can get it to above the -- about to the range the whole Company is right now I think is about where you would get to with those CSK stores. The 42% commercial, somewhere in that area. And that's strictly an estimate based on our knowledge of the stores that we have that are in more retail areas that don't have a lot of professional business around them. I think because of that, we'll have a hard time getting to the position that the core O'Reillys or the historical O'Reilly stores are or were prior to buying CSK.

But the changes over time as we -- leases come due and we make relocations and things like that. But based on the state of our locations today, I would say somewhere in that 40% or low 40% range would be our commercial penetration out there.

Mike Baker - *Deutsche Bank - Analyst*

And did some of the consolidation in the space impact that at all?

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

It can. As acquisitions happen, that could certainly have some impact. Probably the bigger impact will be just the decisions we make as far as potential relocations of stores that might be in locations that are not conducive to the professional business as leases come due.

Mike Baker - *Deutsche Bank - Analyst*

Okay. Thanks a lot, guys.

Operator

We have reached our allotted time for questions. I will now turn the call back over to Greg Henslee.

Greg Henslee - *O'Reilly Automotive, Inc. - President and CEO*

Thanks, Christine. We would like to conclude our call today by again thanking our -- the entire O'Reilly team. You once again have proven that hard work and excellent customer service are the keys to our long-term profitable growth. We are very proud of our excellent starts to 2014, and we're very confident in our ability to build upon our first-quarter accomplishments and continue to gain share across all of our markets.

I would like to thank everyone for joining our call today, and we look forward to reporting on our second-quarter 2014 results in July. Thank you.

Operator

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

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