OVERVIEW:
Co. reported 3Q14 total sales of $1.9b and diluted EPS of $2.06. Expects 2014 diluted EPS to be $7.19-7.23 and 4Q14 diluted EPS to be $1.60-1.64.
CORPORATE PARTICIPANTS

Tom McFall  O'Reilly Automotive, Inc. - EVP Finance, CFO
Greg Henslee  O'Reilly Automotive, Inc. - President, CEO
Jeff Shaw  O'Reilly Automotive, Inc. - EVP Store Operations and Sales

CONFERENCE CALL PARTICIPANTS

Chris Horvers  JPMorgan - Analyst
Scot Ciccarelli  RBC Capital Markets - Analyst
Gary Balter  Credit Suisse - Analyst
Simeon Gutman  Morgan Stanley - Analyst
Mike Baker  Deutsche Bank - Analyst
Daniel Hofkin  William Blair & Co. - Analyst
Alan Rifkin  Barclays Capital - Analyst
Michael Lasser  UBS - Analyst

PRESENTATION

Operator

Welcome to the O'Reilly Automotive Incorporated third-quarter earnings conference call. My name is Ellen and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note that this conference is being recorded. I will now turn the call over to Mr. Tom McFall. Mr. McFall, you may begin.

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

Thank you Ellen. Good morning, everyone, and thank you for joining us.

During today's conference call, we will discuss our third-quarter 2014 results, our outlook for the remainder of the year, and after our prepared comments, we will host a question-and-answer period.

Before we begin this morning, I would like to remind everyone that our comments today contain forward-looking statements, and we intend to be covered by, and we claim the protection under, the Safe Harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as expect, believe, anticipate, should, plan, intend, estimate, project, will or similar words. The Company's actual results could differ materially from any forward-looking statements due to several important factors described in the Company's latest annual report on Form 10-K for the year ended December 31, 2013 and other recent SEC filings. The Company assumes no obligation to update any forward-looking statements made during this call.

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

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

Thanks Tom. Good morning, everyone, and welcome to the O'Reilly Auto Parts third-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.
Once again, I would like to begin our call today by congratulating team O'Reilly on another great quarter. Our team's relentless commitment to providing consistent, excellent customer service every day continues to drive our record-breaking results and allows us to profitably grow market share. And I would like to take this opportunity to thank each of our team members for their hard work and their dedication to our Company’s long-term success.

As you listen to today's conference call, I think you'll find that it sounds very similar to our second-quarter call as we again exceeded our guidance and posted extremely good results. As we saw last quarter, the wear and tear on vehicles caused by the harsh winter continued to contribute to demand for our products and helped us exceed the top end of our 3% to 5% third-quarter comparable store sales guidance with a very robust 6.2% increase. And these impressive results were on top of a solid 4.6% comparable store sales increase for the third quarter of 2013.

Total sales for the quarter increased 8.6% to $1.9 billion and we are especially proud of our team’s ability to robustly grow sales profitably, evidenced by our 18.3% third-quarter operating margin, which is a 94 basis point increase over the third quarter of 2013.

Our team’s commitment to consistent, excellent customer service over the long-term delivered EPS growth of 22% for the quarter, which represents the 23rd consecutive quarter earnings-per-share growth has exceeded 15%.

During our second-quarter call, we discussed the positive sales tailwinds we experienced from the impact of the extreme wear and tear on vehicles caused by the cold temperatures and potholes on the roads created by the harsh winter weather. This tailwind continued into the third quarter and we again saw continued strong performance in our under-car categories such as breaks, driveline, chassis and ride control.

As we also discussed in our last conference call, the lack of extreme heat in many of our markets resulted in lower than normal seasonal sales in air-conditioning related categories, which was a headwind to our third-quarter sales performance. But overall we saw solid results across both maintenance and repair categories during the quarter.

As we look back at the cadence of sales during the period, from the beginning of the quarter through our conference call on July 24, results were slightly softer than the remainder of the quarter but generally very steady week-to-week. We saw solid results across the country with our new markets performing exceptionally well. Our strong comp results were driven by both our professional and our DIY business. However, as we have seen in the past, our professional business continues to outperform as we continue to take share on this side of the business in both new and acquired markets.

In total, comps were driven slightly more by average ticket than traffic. However, we saw solid positive ticket growth on both the professional and DIY sides of the business. The increase in average ticket was driven by product mix with inflation on a SKU by SKU basis continuing to be flat, as we have seen for several quarters now. The growth in average ticket continues to be driven by the long-term trend of increased complexity and cost of vehicle repairs. During the third quarter, this trend was further driven by the high mix of under-car repairs which typically require more costly parts.

Based on our strong year-to-date comp results, we are increasing our full-year comparable store sales guidance to a range of 5% to 6%. Our full-year guidance includes our expectation that fourth-quarter comparable store sales will be in a range of 3% to 5%. The midpoint of our fourth-quarter guidance represents a two-year stack of 9.4%, which is in line with our year-to-date two-year stack of 9.8%.

We expect that the strong business trends we have seen all year will continue into the fourth quarter, but at a somewhat more moderate pace as we face more difficult comparisons from the previous two years. We also expect the improvement in miles driven that began in April of this year will continue as the unemployment environment gradually improves. However, we expect the average consumer will continue to be under significant pressure, especially as we enter the busy holiday spending season.

National average gas prices have declined sharply over the past several months. However, the current prices are similar to the fourth quarter of 2013 and our guidance is based on the assumption that prices will remain around the current level.
Our continued strong sales results are directly tied to the high level of customer service and superior inventory availability provided by our investments in a robust distribution and hub store network, and by the knowledgeable parts professionals behind our counters and on our phones each day. We are very proud of our strong topline performance and our focus on sustainable growth and profitable sales, which is reflected in our continued gross margin expansion.

For the third quarter, our gross margin improved to 51.6% of sales, which was a 71 basis point improvement over the prior year. On a sequential basis, our third-quarter gross margin improved 11 basis points over the second quarter, which was in line with our expectations. Our gross margin improvement continues to be driven by product acquisition cost improvements and a growing mix of higher margin hard parts as a percentage of our total sales mix.

For the fourth quarter, we expect to see a modest sequential deceleration from our third-quarter results based on the mix of business and normal lower seasonal sales volumes. However, compared to the fourth quarter of 2013, we expect to see a significant be stronger gross margin as a percentage of sales.

You may recall during the fourth quarter of 2013, we had a gross margin headwind of approximately $14 million from LIFO charges resulting from supplier deals finalized during that quarter. Tom will provide more detail around those charges during his prepared comments in a few minutes.

Based on our year-to-date results and our expectations for the fourth quarter, for the full year, we are tightening our gross margin guidance to a range of 51.2% to 51.4% of sales. This guidance is based on the assumption of continued limited inflation and rational industry pricing.

As we step back and look at the industry as a whole, we remain very confident in the overall health of the automotive aftermarket and in the long-term drivers of demand for our products, including an increasing rate of new vehicle sales and stable scrappage rates which have resulted in both a growing vehicle population as well as an aging vehicle population.

As we have stated in the past, with proper maintenance, the high quality vehicles which have been manufactured over the last decade can reasonably be expected to stay on the road for historically long periods of time and can be reliably driven at very high mileages. This combined with the increasing rate of new vehicle sales bodes well for continued strong future demand for the automotive aftermarket, and we feel we are very well positioned to translate that demand into market share gains.

Thanks to the dedication of our over 67,000 team members, we continue to aggressively and profitably grow our market share. And their hard work and commitment to providing unsurpassed levels of customer service generated a year-to-date comparable store sales growth of 5.9%. Their focus on profitable growth leverage these market share gains into a year-to-date operating margin of 17.7%, which is an increase of 88 basis points over the prior year.

We are confident that our team will continue to execute our proven model at a very high level. And based on the strength of our team, our very strong year-to-date results and our continued confidence in the long-term drivers for demand in our industry, we are raising our full-year EPS guidance from a range of $7.00 to $7.10 to a range of $7.19 to $7.23. Inherent in this revised full-year guidance is our fourth-quarter EPS guidance, which is a range of $1.60 to $1.64.

Finally, I would like to once again thank team O'Reilly for our record-breaking third-quarter performance and their ongoing commitment to our continued success. We are very proud of our team and we are very confident in our ability to continue our long track record of profitable growth.

With that, I'll turn the call over to Jeff Shaw.

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

Thanks Greg and good morning everyone. I'll begin today by echoing Greg's comments and expressing my sincere appreciation to team O'Reilly for another incredible quarter.
Our industry-leading 6.2% comparable store sales results for the third quarter and our year-to-date 5.9% comparable store sales results couldn’t have been accomplished and wouldn’t be possible without the dedication of all of our team members working together each day to provide consistent top-notch customer service. It takes all of our store, DC, and corporate team members’ relentless focus on out-hustling and out-servicing our competitors to achieve this level of market share gains, and for that and so much more I thank you.

I’ll now take a few minutes to add some color to our operational results for the third quarter, including the progress in our distribution expansion activities and our new store expansion. SG&A levered 22 basis points for the third quarter due to our strong comp performance. Average SG&A per store increased 3.5%. Similar to our second quarter, the increase in average SG&A per store for the third quarter was higher than we expected and was driven by higher than expected litigation and team member costs.

We continue to work hard at limiting our exposure to litigation costs, especially as it relates to the more highly regulated markets where we operate. However, during the third quarter, we again experience some negative outcomes on certain litigation that is inherent in the normal course of our business.

On the team member cost front, we have always managed these costs at a granular level. Our operations groups, both stores and DCs, are passionately focused on ensuring our store staffing levels are appropriate to control costs while at the same time providing consistent, top-notch customer service that allows us to profitably grow our business.

As I mentioned in the past, we do not make dramatic short-term changes to store staffing levels, but rather make measured adjustments to support current business fluctuations balanced against future growth objectives. This long-term perspective on store staffing levels has been instrumental to our past success and is critical to our ability to continue to profitably grow our market share.

We believe our year-to-date comparable store sales increase of 5.9%, coupled with our year-to-date SG&A leverage of 29 basis points, tells us we are successfully accomplishing this goal. Based on our year-to-date results and our expectations for the fourth quarter, we now expect that our average SG&A per store will increase approximately 3% for the full year.

Before I provide an update on our distribution expansion projects, I want to once again spotlight the exceptional strength of our distribution operations team. When we talk about customer service on these calls, we always discuss the high service levels we provide to our professional and DIY customers. However, our culture is to provide exceptional customer service to all of our customers, including our internal customers.

A perfect example is our DC teams who relentlessly focus on providing industry-leading customer service to each of our stores, which enables them in turn to provide unsurpassed parts availability to our professional and DIY customers. With two new DCs coming online already this year and a third which just opened this past week, our DC operations team has been extremely busy. However, they are extremely experienced in managing DC openings in rapid succession and their level of service to our stores has not missed a beat. I’d like to take this opportunity to thank our DC teams for their continued hard work and dedication.

Now for the specifics on our DC expansion projects, our Lakeland DC, which opened in January, has significantly improved our parts availability in the Florida markets where we continue to aggressively grow our market share. Our Chicago DC came online at the end of the third quarter and is already servicing 118 stores after only 31 days of operation. It will service the 165 stores that currently exist within its service radius by early November, with capacity to service up to 250 stores, which positions us for sustained growth throughout the upper Midwest.

Our newest DC in Boston opened this week and we’ll transfer stores from our existing DC in Maine to this facility over the next several weeks. We are very excited about the growth opportunities in the Northeast, and this new facility will provide us the capacity for an additional 224 stores.

Switching gears to store expansion, during the third quarter, we opened 54 net new stores and we remain very confident in our plan to open 200 net new stores for the full year. During the quarter, we opened stores in 27 different states, which has to be a record number of states for us. Leading the pack were 11 store openings in Florida where we continue to leverage our new Lakeland DC and profitably grow our market share. Also included in this quarter’s openings was our first store in Pennsylvania, our 43rd state.
As I’ve mentioned in the past, our coast-to-coast footprint allows us to be very selective in new store site selection and allows us to develop and train great teams of parts professionals who are ready to provide top-notch customer service the day a new store opens. We have capacity for future growth across our robust distribution network enhanced by the current DC openings. We are very pleased with the performance of our store openings over the past several years and we continue to be very confident in our ability to grow our store base in both new and existing markets. Based on these factors, we are establishing a goal of 205 net new store openings for 2015. And similar to this year, the growth will occur across our entire footprint.

I’ll finish up today by reiterating that O’Reilly has been successful over the years by focusing on the fundamental concept of offering consistent high levels of service at competitive prices. This is a seemingly simple mission but it requires a tremendous amount of elbow grease each and every day to out-hustle our competition and grow market share. And I’d like to once again thank our team for their unwavering focus on providing these high levels of service every day.

Now I’ll turn the call over to Tom.

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

Thanks Jeff. I’d also like to begin today by thanking team O'Reilly for your continued dedication to excellent customer service, which drove our outstanding third-quarter performance.

Now we will take a closer look at our results and provide updates to our guidance. Comparable store sales for the third quarter increased 6.2%, which exceeded our guidance of 3% to 5% as we benefited from continued strong demand in hard part under-car categories. For the quarter, sales increased $149 million, comprised of a $105 million increase in comp store sales, a $43 million increase in non-comp store sales, a $2 million increase in non-comp non-store sales, and a $1 million decrease from closed stores. This strong sales performance combined with solid expense control resulted in a 22% increase in diluted earnings per share to $2.06, which exceeded the top end of our third-quarter guidance range by $0.11.

Now I’d like to update you on gross margin and the impact LIFO accounting had on our margins. As we discussed in the last several 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 gross margin as we adjust our existing inventory on hand to the lower cumulative acquisition costs.

During third quarter, our gross margin of 51.6% included a LIFO headwind up $6 million, which was slightly higher than we projected going into the quarter, but still within our expectations as we continued to be successful in reducing acquisition costs.

Looking forward to the fourth quarter, we would continue to expect to see some LIFO headwinds. However, year-over-year comparison to the fourth quarter of 2013 benefits significantly from calendaring the $14 million LIFO impact we saw last year. This year-over-year benefit is incorporated into our full-year gross margin guidance range, which we have tightened to 51.2% to 51.4%.

Our effective tax rate for the quarter was 34.7% of pretax income versus 35.3% in the third quarter of 2013 as a result of better-than-expected job tax credits. These higher-than-expected benefits were a $0.02 tailwind to our EPS growth for the quarter. For the full year, we now expect our effective tax rate to be approximately 36.3%.

Moving to the balance sheet, inventory per store at the end of the third quarter was $584,000 versus $570,000 at the beginning of the year. While the majority of this increase is the result of the seasonality of our business, we are slightly above where we expected to be at the end of the third quarter as a result of our decision to hold additional inventory to protect ourselves from any disruptions or potential disruptions that could occur from the West Coast Longshoremens strike. As a result, we now expect inventory per store for the full year to be slightly above last year, but we remain diligent in our efforts to add the right inventory, leverage our existing investment and minimize nonproductive inventory.

At the end of the third quarter, our AP-to-inventory ratio was 95.7%, representing an improvement of 910 basis points from the end of 2013. While the seasonality of our business in the second and third quarters and higher-than-expected inventory balance both yielded higher AP-to-inventory percentage, 95.7% is above our expectations. We will give back some of this gain by the end of the year as sales and replenishment volumes...
seasonally decrease, but based on the current support we are getting from our suppliers, we now expect our AP-to-inventory percentage to be in the low 90s% at year-end.

Year-to-date capital expenditures were $317 million and we continue to expect our 2014 CapEx to be within the range of $390 million to $410 million. This leads us to free cash flow, which was $666 million for the first nine months of the year versus $420 million in the prior year. Based on the above planned income and our increased year-end AP-to-inventory expectations, we are raising our full-year free cash flow guidance to $675 million to $725 million.

Moving on to debt, we finished the third quarter with an adjusted debt-to-EBITDA ratio of 1.77 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. However, we remain very committed to prudently managing our debt levels so that we can maintain or improve our investment-grade ratings, which is a critical factor to the success of our vendor financing program.

We also continue to execute our share repurchase program, and in the third quarter, we repurchased 2.5 million shares of common stock at an average cost of $152.42 per share for a total investment of $387 million. Subsequent to the end of the third quarter through yesterday, we repurchased an additional 1 million shares at an average price of $150.55 per share for an additional investment of $156 million. We are pleased with the execution of our program during and after the end of the third quarter as macro market conditions allowed us to move aggressively and repurchase more shares. We continue to view our buyback program as an effective means of returning available cash to our shareholders after we take advantage of opportunities to invest in our business at a higher rate of return. And we will continue to prudently execute our program with an emphasis on maximizing long-term returns to our shareholders.

For the fourth quarter, we are establishing diluted earnings per share guidance of $1.60 to $1.64. Based on our above planned results in the first nine months of the year and additional shares repurchased since our last call, for the full year we are raising our guidance to $7.19 to $7.23 per share. As a reminder, our diluted EPS guidance for both the fourth 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 like to once again thank the entire team O'Reilly for your continued dedication to the Company's success. Congratulations on another record-setting quarter.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Chris Horvers, JPMorgan.

Chris Horvers - JPMorgan - Analyst

Thanks, good morning guys. On the polar vortex and the cadence of the quarter, can you talk about how that's played out throughout the year? It seems like there was a big DIY lift in its transition to the commercial side. But has any of that faded, and did any of that contribute to the cadence of the sales during the quarter?

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

It's really hard to know. When we open our stores every day, we are out building demand by calling on customers, and we're waiting for demand for DIY customers to walk in our store driven by marketing and advertising to some degree. The best way for us to look at it is just the types of sales...
we make, what products are selling best and those kinds of things. And I can tell you that many of our hard parts categories, many of which would be subject to the extreme winter that we had, under-car parts, ride control, chassis, brake parts to some degree, that those categories have done well. At the same time, some of our maintenance categories, motor oils, filters, stuff like that where people are just maintaining their cars, they did well also. So, it’s really a hard thing to quantify.

The vehicle population continues to age, so we are at record levels now. So it’s a little bit of an unknown as to what types of parts will have the most demand as vehicles go through their second round of major maintenance or third round of major maintenance or whatever it is. But we know it has some positive effect. It’s just hard for us to quantify.

**Chris Horvers - JPMorgan - Analyst**

So it’s not as if you could say there was really much of a fading that occurred during the past few months?

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

We would not be able to say that. It would really hard for us to say that a big portion of the improvement in business we’ve seen this year is related to that. We just speculate that based on the types of sales we make and the sales that we make by category.

**Chris Horvers - JPMorgan - Analyst**

Interesting. And then Tom, I was curious. It doesn’t look like – well, you didn’t take out any debt through the third quarter. Historically in the past couple of years, you have taken out debt in the third quarter. How do you think about the need to add leverage in the fourth quarter to execute the buyback? Thanks.

**Tom McFall - O’Reilly Automotive, Inc. - EVP Finance, CFO**

We still have quite a bit of cash on hand, as we talked about in our comments. Our AP-to-inventory ratio has exceeded our expectations this year, and our goal is to run with minimal cash on the balance sheet. We continue to deploy that cash against new DCs and new stores, and to the extent we have extra to buy back shares in a prudent manner. So until we have used up the cash on our balance sheet, I would expect that’s not to look to add more leverages. We don’t want to pay for the negative carry cost.

**Chris Horvers - JPMorgan - Analyst**

Understood. Thanks very much.

**Scot Ciccarelli, RBC Capital Markets.**

They actually got Ciccarelli right. A lot of retailers have to make a trade-off between gross margin and payable terms. And yet you guys have been able to post pretty consistent improvements in product procurement costs the last few years, and obviously as we’ve talked about, the improvement we’ve seen in payable-to-inventory ratios. What’s the right way to think about your vendor negotiations going forward on both of these fronts? And is there a preference on your part to focus on more on one side of the ledger than the other?
Greg Henslee - O'Reilly Automotive, Inc. - President, CEO

We focus on both. Of course, payable terms has been a significant initiative of ours over the past five years or so, especially post-CSK. But at the same time, as our company grew as much as it did with the CSK acquisition, we expected to be looked at a little bit differently by some of our suppliers. We are very fortunate to be a company that has strong partnerships with many of our best suppliers, and I feel like and I hope that we are a preferred customer for those suppliers. And I think, for that reason, we are in a good position to negotiate well on both fronts.

In a rising interest rate environment, of course that changes as suppliers’ cost when it comes to doing business with us, if they are taking their money on factoring program, and if we are ever in that environment then we will of course weigh that in those negotiations. But right now, I would say we weigh both as important factors. And with each vendor, it’s a different type of negotiation, but we don’t really lean one way or the other right now.

Scot Ciccarelli - RBC Capital Markets - Analyst

Okay. And yet, Greg, you mentioned if we do get in a rising interest rate environment, there might be more of a focus on the gross margin side rather than the payable, that would be the trade-off you’d be looking for?

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

Tom, do you have any comments on that?

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

When we look at a rising interest rate environment, that’s the same for everyone. To the extent that that happens, when we look at vendor supply financing, it’s really that incremental rate and access to capital earlier. To the extent that interest rates go up, we would expect to see inflation in the acquisition cost and the retail cost of our items, so really when we look at vendor financing, it’s centered around what’s that incremental spread over LIBOR.

Scot Ciccarelli - RBC Capital Markets - Analyst

Got it. All right. thanks a lot guys.

Operator

Gary Balter, Credit Suisse.

Gary Balter - Credit Suisse - Analyst

First of all, congratulations to you and everybody else on the team on a great quarter again. This is probably more for Jeff. You talked about all the DCs that are opening, how well Florida is doing, Boston, Chicago, etc. The other companies that you look at, whether it’s Advanced with World Bank, and now AutoZone with their acquisition of what I will call World Bank mini -- I forget the name. They're doing those separately. And you guys have a pretty big international program going on. Is that all flowing through your DC, and is that being treated -- is there a separate salesforce or anything separate in your international efforts, or is that all part of the overall O'Reilly experience? Thanks.
Jeff Shaw - O'Reilly Automotive, Inc. - EVP Store Operations and Sales

No, no, no, it's all ran through O'Reilly. It’s O'Reilly salesforce and O'Reilly stores. Kind of the way we look at this is -- and we've looked at it for this way for a long time -- even back in my young days with the Company, one of the first positions I came into when I came to the corporate office was in our inventory management department. We have always looked at the parts that we deploy in our stores and our distribution centers based on the vehicles that are being driven in each market. And I think we were one of the first adopters of using vehicle population as a means of deploying inventory.

So as import cars have become more prevalent, we have focused our efforts on making sure that we have the parts that fit the cars that are being driven. And to the extent that there is a brand or product type preference by the individuals that are using those parts, we've made sure that the products we carry are appropriate. And that's why the private label line that we now have that covers more of the international car part has done as well as it has and will continue to expand that. And because we have such a strong distribution network, and because we've always done it this way, our sales team is just kind of geared to speak to both specialists on import cars, specialists on domestic cars. And really today they are more mixed than ever, although there is a population of shops who specialize in imported cars that sometimes like to use more OE-type parts and we are gearing our import direct line to better fit those types of shops.

Gary Balter - Credit Suisse - Analyst

Thank you very much. Good luck guys.

Operator

Simeon Gutman, Morgan Stanley.

Simeon Gutman - Morgan Stanley - Analyst

Thanks and congratulations as well, and thanks for the 4:30 Eastern release.

First, Greg, on the top line, which has been strong for a while, and I think surprised people even this quarter, can you talk -- can we try, I don't know, to parse out what you think is really driving it? You mentioned under-car. Can you give us a sense of what the average price point for an under-car parts or repairs look like? Are you selling more items per basket? We've talked about loyalty programs. Is that making a difference? Is your in-stock level difference? I'm sure it's a host of a lot of these things, but if there's anything to pinpoint, I'd appreciate it.

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

It's the sum of all the things you mentioned. The number of items per ticket we have not seen a significant swing in that. Probably what I would lean on most is what I said in my prepared comments, and that is that as we continue to see a vehicle population that is a little more complex, uses more technology, vehicle repairs cost a little more. And while on a SKU by SKU basis we don't see inflation in what a part costs this year versus what it cost last year and what it sells for, we are seeing the demand for parts that cost a little more be a little higher in these under-car repairs that are typically the result of both higher mileage vehicles and also vehicles that have weathered a rough winter at these higher mileages. Those are good drivers of ticket average. And we continue to see a little uptick in our ticket average.

Of course, the do it for me side of the business is a higher ticket average than the DIY side of our business, primarily for that reason, because most of those repairs are not light repairs. They are repairs that are more heavy repairs and the DIY customers tend to focus on repairs that are typically more light type repairs.
Simeon Gutman - Morgan Stanley - Analyst

My follow-up is on gas prices. We know that they go down. They should be good but I think -- I forget if it was you or Tom mentioned in the remarks that we are not that different from a year ago. What about gas prices that coincide or lower gas prices that just happen to coincide with the holiday period? So, if you look back at fourth quarters, does intend to have a more diluted impact because there’s other discretionary dollars moving around, and maybe we see some deferral until next year, or does holiday period not matter, it’s more about what that customer can buy today?

Greg Henslee - O’Reilly Automotive, Inc. - President, CEO

I’ll let Tom make a comment on it.

Tom McFall - O’Reilly Automotive, Inc. - EVP Finance, CFO

What we see in the fourth quarter is it’s our most volatile quarter. It’s the most weather-susceptible. People are making the choice to spend their dollars on the holidays, and to the extent that they can defer maintenance, they will. Luckily for us, it’s also the lowest volume quarter on a daily basis. So although it’s great to have lower gas prices than we had in the third quarter, we wouldn’t expect in this quarter to have a huge impact. To the extent that they stay around this number for multiple quarters, we would expect to see a year-over-year advantage in 2015.

Simeon Gutman - Morgan Stanley - Analyst

Okay, thank you.

Operator

Mike Baker, Deutsche Bank.

Mike Baker - Deutsche Bank - Analyst

Thanks guys. I wanted to ask two questions. One, just on your loyalty card, can you update us there? How is the penetration? Is it growing year-over-year? And what do you expect going forward?

And then secondly, just in general, some industry data that comes up and some of your competitors seem to have softened a little bit this quarter. You guys were better. To me, that’s clearly market share gains. But could you just address that? How much of your comp acceleration this quarter do you think is due to external factors, and how much do you think is market share gains, if there’s any way you can parse that out? Thanks.

Greg Henslee - O’Reilly Automotive, Inc. - President, CEO

On our loyalty program, we continue to be very happy with it. It’s based on the analysis that we do. Those customers are very loyal customers. Their ticket average is higher, and so we are very happy with those customers. We think -- I haven’t got an update in a couple weeks but I think we are probably around 9 million customers that are signed up for that program now and actively using it. So we are very pleased with it, and I would say that it’s a contributor to our DIY business growth.

On whether our results are the results of just the industry dynamics or the market share gains, I’d say it’s a little bit above -- it’s really hard to speak to why our comps are better than some of our competitors’, but I would say that we work hard to make that happen. It’s kind of every day when Jeff and his guys are out on the street making sales calls and we are competing with all the guys we compete with, we very respectfully try to get a little more market than they do. So to the degree that we are successful at that, we are very happy with that, but I at the same time feel like we
are in a very solid industry, one that is growing at a steady pace and one that offers all of us good opportunity to grow our business. And just like they are, we are out there every day trying to take as much market share as we can, and we are very fortunate to have had the success we've had.

**Mike Baker - Deutsche Bank - Analyst**

Great, thanks. I'll turn it over to one of my colleagues to ask some questions. Thanks.

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**Operator**

Daniel Hofkin, William Blair & Company.

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**Daniel Hofkin - William Blair & Co. - Analyst**

Good morning. Great quarter. I just wanted to follow up a little bit on the DIY. And I guess in addition to loyalty, maybe you could sort of rank order the things you think have been most impactful on your DIY business, which seems to be outperforming the category, the DIY segment in general, in particular the last couple of years. Just wondering. Is it loyalty? Is it some of your POS initiatives, some of the store labor, bilingual initiatives, just what you think has been most impactful so far and how sustainable you think that is for the next year or two?

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

The thing I think is the biggest driver of our DIY success, I feel like is very sustainable because it's our people and it's the service that we provide, and it's been the initiatives that we've put in place over the last two or three years to be a little more aggressive when it comes to the life services that we provide for our DIY customers that walk in our stores.

As we've talked about in the past, we've always been very careful not to intrude on the businesses for our most important customers, which are our professional customers. But as we realize that many DIY customers, these light jobs they're going to do like a battery or wiper blades or a taillight bulb or something like that, they're simply not going to take their vehicles to a shop to do those things. And some of our competitors were quickly providing those services in their parking lot, and we decided let's do some of those things too. And I think that to the degree that we have very, very good and knowledgeable professional parts people in our stores, we're pretty good at that stuff. And as we kind of allowed them to be a little more focused on those kinds of services, it's played out very well for us on the DIY growth side.

So, I would say that service number one. I'd say product availability, I'd put that right there too. Our distribution network and our hub store network and the number of drops in the stores in metro areas get each day from either a hub store or distribution center is very powerful. If you're a DIY customer and you walk into one of our stores and we don't have something in our 24,000 SKU mix in an average store, to have double or three times those SKUs available in a hub store, and five, six, seven times those SKUs available from a distribution center is a big deal. Having the part sometimes makes all the difference and being able to get it in the customer's hand the quickest makes a lot of difference. And I'd say those things would be what I would say are the most important.

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**Daniel Hofkin - William Blair & Co. - Analyst**

Okay, great. And then I just had a quick follow-up. You made a comment I think during the prepared remarks about the cadence. Could you just repeat that a little bit, the cadence kind of as the quarter progressed, and where that -- if there was a change in that, if it was more pronounced in DIFM or DIY? Thank you.
Greg Henslee - O'Reilly Automotive, Inc. - President, CEO

Both DIY and DIFM were pretty comparable throughout the period. The period started out -- it was very steady week to week, so I don't want to make this seem as though there was any dips or soft spots, because there really wasn't. But it did start out a little bit softer than what it ended. The best part of the quarter was on the end and the weakest part was on the beginning, but the differences there were not very significant.

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

What I would add to that is, in the beginning of July, we didn't see much heat in air-conditioning or air-conditioning related projects, our big seller during that period. And though the under-car business was very similar throughout the quarter and strong, that lower temperatures and less of that seasonal business made the beginning of July slightly softer.

Daniel Hofkin - William Blair & Co. - Analyst

Okay, great. Thanks very much guys.

Operator

Alan Rifkin, Barclays.

Alan Rifkin - Barclays Capital - Analyst

Thank you, and I'll certainly add my congratulations as well. A couple of times, Greg, you mentioned the outperformance of stores in the newer markets. I was wondering if you could add a little bit more color. Where exactly are you seeing the greater performance? Is it on the DIY or the commercial side, and who do you think you're taking share from in some of those newer markets?

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

As has historically been the case, when we open a new store, we typically perform a little better to start on the DIY side than we do the do it for me side as we gain credibility and kind of establish ourselves as a worthy provider.

In some of our newer markets, and I'll mention the Southeast for instance because I'd rather not talk about all the markets that we do well. We focus on trying to get all of our new stores off to a good start. But in the Southeast for instance, where we built a really strong team of professionals that are very capable of servicing the do it for me market, they know the lingo, they know the parts, our do it for me business has started off quicker in those markets than they historically have in our new stores.

As far as who the market share comes from, it's everyone that's in the do it for me business there to some degree. There's no -- I don't feel like we take business away from one competitor more than others. And many times, we don't know for sure who all a shop is buying parts from, because almost never do you exclusively have all of the shops parts business. It's usually shared between multiple suppliers to some degree. Of course, we all try to get all of their business but none of us are very successful at actually getting 100% all the time. But it's everyone doing business down there.

Some of our toughest competitors these days are two-step under-car warehouses that focus just on the do it for me side, have good people running their locations, and have good access to inventory, good brands, high-quality products, solid pricing, all those things. So, those companies are companies that we feel like we take business from, but then also our publicly traded competitors who do so well also, we feel like, in new markets, we are happy to be able to share of business with them as we open a new store and establish ourselves as a worthy provider.
Alan Rifkin - Barclays Capital - Analyst

Okay. Greg, one more for you if I may. You talked about the benefits of the weather, but here we are, we’re really seven, eight months removed from the end of the winter and we are really on the cusp of a new winter first starting. Have you -- and I know you guys are pretty modest, to be fair, but have you ever seen a tail as long as what you have seen in 2014 from the weather? And is it possible that it’s really not the weather helping you, but really there are secular improvements at your stores such that the market share gains are permanent regardless of weather patterns?

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

Let me make a comment and then I'll let Tom make a comment too. What I would say is we've been through a lot of tough winters. This is my -- I'll be here 30 years in November. And there's been a lot of hard winters and we've had good business following those.

I've never -- I don't remember a tough winter that we've talked about as much as we have this year. And I'm not really sure what's driven that, other than the fact that I guess maybe those of us that report publicly have mentioned it enough times that we've drawn a lot of attention to it.

What I would say is that some portion of our comp store sales results and the success we are having is related to the fact that we've had some -- a tough winter and that helps business. I think probably a bigger driver of demand these days is just the fact that vehicles are staying on the road longer. And the good drive trains, the better bodies, the lack of rust, the better interiors make cars more comfortable and make consumers more willing to drive them at higher mileages. And I feel like that's at least as big of a contributor, but I know the extreme weather is also a contributor. But that's really about the extent of my analysis on that, because we really just don't have good information to put me in a position where I could say anything different. But I think Tom might have some comments too.

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

Alan, what I would comment on is 2014 has been a much better year than 2012. If we look back to 2012, had a very, very mild winter and we saw demand in our industry be soft through the third quarter. So I think this is the opposite of that.

Alan Rifkin - Barclays Capital - Analyst

Okay. And just one last quick one for Jeff. Jeff, you mentioned that SG&A per store year-to-date is up 3.5% but you're looking for 3% for the year, which would imply only 1% to 1.5% in Q4. Especially with Q4 being a relatively low revenue quarter, what would be driving a pretty significant decline in SG&A spending per store in Q4?

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

As we mentioned in the prepared comments, and Greg just mentioned earlier, there's been some initiatives that we've focused on in the past nine to 12 months, whether it be the retail initiatives, maybe some additional retail staffing for entitlement, as well as just our investment in hub stores. We've invested quite a bit of money in hub inventory, but you've got to distribute that inventory. And to distribute that inventory, it takes infrastructure, material handling, trucks, staffing to move those parts from hubs to the spoke stores, additional routes. And for the most part, we are in pretty good shape on that now going into the fourth quarter.

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

As we do every year, we expect a seasonal decline in business. And we staff our stores appropriately. During the summertime, we have be pretty aggressive making sure, as Jeff said, that our service levels were high and we were in the best position possible to gain market share in a relatively robust market.
The fact that we are in a seasonal decline now is not something that’s unforeseen, and we are in the process now of gearing our stores and making sure our schedules are set to reflect this expected decline in business. And that’s the reason for the 3% SG&A increased forecast for the year.

Alan Rifkin - Barclays Capital - Analyst

Okay. Thank you very much. Good luck.

Operator

Michael Lasser, UBS.

Michael Lasser - UBS - Analyst

Good morning. Outside of the quarters that you were incorporating CSK, you haven't had three quarters in a row of SG&A per store growth north of 2.5% going back all the way since the 1990s. And now that your overall operating margin is approaching 17.5%, is it just harder to get some inherent leverage in the business? Maybe another way to say it is are you having to invest more operating expenses in order to drive the growth?

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

I think I would say this, Michael. You make a lot of choices in a business our size relative to what the opportunities are, kind of the way you go to market. In this case, we are in, we feel, like in a period of significant growth, and we are having a lot of success with some of the initiatives that we have underway now. We are putting -- trying to put ourselves in the best position possible to continue to gain market share.

Could we run our stores at a lower payroll than we run them today? Yes, we could. And could we do so and generate the comp store sales that we are currently generating? I don't know. I don't think we could or we would be doing that. So to some degree, it's really our own initiatives that are driving that, but at the same time, we know we have opportunity to better manage overtime, to better manage our schedules, to optimize how we staff our stores and that we staff for the right for traffic on both sides of the business at the right time, and things like that. So there's always opportunity. But there's nothing happening that we are not seeing coming and planning for. And really what I would say is what we're doing right now is driven by intent and our comp store sales is driven to some degree by the fact that we are ratcheting up our service levels.

Michael Lasser - UBS - Analyst

And that's helpful commentary and very fair. I guess my question is do you have to make those investments in order to drive the comp today, whereas maybe five or 10 years ago, you didn't have to make as such intense investments because the stores were at a less maturity stage?

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

I wouldn’t say we have to. What I would say is we are in a position where we are not comfortable not making those kinds of investments in what we view as customer service initiatives and putting our stores in the best position to provide the highest levels of service. The only way you really know is to ratchet it down and see what happens. Right now, we just in a position where we would want to continue growing comp store sales at a robust rate, so we are making sure that we put ourselves in the best position to do that.
That makes sense. The other question I had is we've heard that there's been some changes amongst your competitors and different vendors in the industry on the heels of some consolidation. Do you think that that has in turn benefited you at all? Have some of these vendors come to you and say you've become more important to us because we are no longer dealing with some other players in the industry?

Yes, I think that's helpful to us. As a matter of fact, I won't mention the brands, but I think I know exactly the brand you're talking about. And yes, we are pretty pleased with that. I think, on a couple of fronts, one, there's a lot of demand for those products. And the customers that use those products most prevalent are professional customers, so you know where they're at. We can call on them. We have competitors that have those products too, so it doesn't all come our way. You have got to go out and work for it and earn it. But we are also very pleased with the fact that those, the suppliers of those products recognize us as a company that they want to represent them in marketing those products. So that's a good feeling, knowing that some of the most important brands and suppliers in the industry have chosen us whose business model is really similar these days to some of our more retail competitors as they've made a transition towards professional. We are very happy that they continue to rely on us as a company that can adequately represent the very valuable brands that they own.

Okay. That's very helpful. Thank you very much.

We have reached our allotted time for questions.

Okay. Thank you Ellen. We would like to conclude our call today by thanking the entire O'Reilly team for an outstanding quarter. Our record-breaking results are directly attributable to your continued focus on providing consistent, exceptional customer service.

We are very proud of our strong year-to-date results. We remain extremely confident in our ability to continue to aggressively and profitably gain market share, and we are focused on finishing off a record-breaking year with a strong fourth-quarter performance.

Thanks to all of you for attending our call today and we look forward to reporting our 2014 fourth-quarter and full-year results (technical difficulty). Thank you very much.
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