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ORLY - Q4 2014 O'Reilly Automotive Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 05, 2015 / 4:00PM GMT

OVERVIEW:

Co. reported 2014 sales of $7.2b and EPS of $7.34. Expects 2015 revenue to be $7.6-7.8b, 2015 diluted EPS to be $8.20-8.30 and 1Q15 diluted EPS to be $1.89-1.93.

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Seth Basham *Wedbush Securities - Analyst*

Michael Lasser *UBS - Analyst*

Simeon Gutman *Morgan Stanley - Analyst*

Scot Ciccarelli *RBC Capital Markets - Analyst*

Chris Horvers *JPMorgan - Analyst*

Alan Rifkin *Barclays Capital - Analyst*

Daniel Hofkin *William Blair & Co. - Analyst*

Michael Montani *Evercore ISI - Analyst*

PRESENTATION

Operator

Welcome to the O'Reilly Automotive, Inc. fourth-quarter earnings release conference call. My name is Vanessa and I will be your operator for today's call. (Operator Instructions). Please note that this conference is being recorded.

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

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

Thank you, Vanessa. Good morning, everyone, and thank you for joining us. During today's conference call we will discuss our fourth-quarter and full-year 2014 results, our outlook for the first quarter and full year of 2015; and after our prepared comments, we will host a question-and-answer period.

Before we begin this morning, I'd 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 and CEO*

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

I'd like to begin our call today by congratulating Team O'Reilly on another great quarter, which closes out a very successful year. Our team's ability to consistently grow market share by providing excellent customer service, day in and day out, is highlighted by our comparable-store sales results, which exceeded 5% each quarter of 2014, and finished at 6% for the full year.

Our goal is not just to grow our market share, but to grow it profitably. And again, our team's commitment to customer service drove exceptional results in 2014, as we set record-high quarter operating margins each quarter of the year. These consistently outstanding results are the result of the hard work and dedication of each of our team members. And I would like to thank our team for their relentless commitment to our ongoing success.

As we have seen the past three quarters, undercar repair such as brakes, driveline, chassis, and ride control were key contributors to our strong 6.3% comparable store sales increase for the fourth quarter, which exceeded our guidance of 3% to 5%. The strength in undercar categories, along with general strength in all hard parts categories, drove comparable store sales of 6% for the year, which exceeded our guidance from the beginning of the year of 3% to 5%.

For the year, we increased sales by $567 million to $7.2 billion. And we are especially proud of our team's ability to profitably grow market share, as we achieved another quarterly record operating profit of 17.2% in the fourth quarter, culminating in a record full-year operating profit of 17.6% for 2014, which is a 100 basis point increase over 2013.

Our ability to profitably grow market share, combined with the prudent expense control, yielded earnings per share growth of 26% for the quarter, representing our 24th consecutive quarter with earnings per share growth in excess of 15%. For the year, earnings per share increased to $7.34 a share, which is a 22% increase over the prior year, and represents the sixth consecutive year of EPS growth in excess of 21%.

For the quarter, our comparable store sales were a robust 6.3%, on top of strong comps in the fourth quarter of 2014 of 5.4%. Sales volumes during the quarter were relatively consistent. However, comparable store sales percentages slowed somewhat in December as we faced our toughest comparisons. Both our DIY and our professional comparable store sales were strongly positive for both the quarter and for the year.

I would now like to discuss our comparable ticket count and average ticket size results, and how these factor into our view for 2015. For the quarter and full year, we consistently and robustly grew our professional comparable transaction count as we very successfully grow in new and acquired markets. We expect to continue to aggressively grow our professional business throughout 2015.

On the DIY side of the business, we generated comparable traffic growth for both the quarter and for the year. Our improved DIY business is the combined result of our focus on opportunities on this side of the business, which Jeff will discuss in a moment, and the gradual improvement in the health of the DIY consumer.

During the year, the unemployment rate has dropped from 6.7% to 5.6%. This improvement has contributed to a consistent, yet somewhat modest, growth path in miles driven. And we are optimistic this trend, combined with lower gas prices, will be a tailwind to the DIY business in 2015.

Average ticket increases are due to an increased mix of hard parts sales and increased parts complexity, which drives up the average repair cost. The increase in average ticket has not benefited from inflation for the past two years. And we have seen less than 0.5% of inflation on selling price of like parts.

This recent trend is below historic norms, and creates a headwind to the comp growth we expect in 2015. However, we expect to see continued growth in average transaction size, driven by increased parts complexity and cost of repair, which we firmly believe is a long-term driver in our industry.

For the first quarter of 2015 and the full year, we are establishing comparable store sales guidance of 3% to 5%. In developing our guidance, we expect miles driven will continue to increase at a moderate rate and benefit demand in our industry. We base this view on the improving health of the consumer; and, for the time being, lower gas prices.

We further expect to see continued growth in miles driven, specifically in the population of out-of-warranty vehicles, as the better engineered and manufactured vehicles from the past 15 years are capable of being reliably driven at high mileages if reasonably maintained. We believe this is an ongoing, long-term trend that will benefit our industry for the foreseeable future.

Finally, our comparable store sales expectations assume pricing in the industry will remain rational; and, as I previously noted, inflation will remain muted.

While we expect each of these factors to be tailwinds for our business in the coming year, we will face tough 2014 comparisons in every quarter of 2015. Ultimately, our ability to grow our comparable store sales in 2015 and beyond is based on our team's commitment to providing the highest levels of service in our industry, and I'm very confident that commitment is very strong. Not only has our team been able to increase our total sales by 8.5% over the prior year, but the sales increase represents sustainable, profitable growth, which is reflected in our strong gross margin expansion.

For the year, our gross margin improved to 51.4% of sales, which was a 73 basis point improvement, and at the top end of our beginning-of-the-year gross margin guidance of 50.9% to 51.4%. During the year, our gross margin improvement was driven by significant product acquisition cost improvements, and a growing mix of higher-margin hard parts as a percentage of our total sales mix.

Looking at 2015, we are setting our gross margin guidance at 51.8% to 52.2%. Our assumptions in developing this guidance are based on the abatement of the LIFO impact we experienced in 2014, which Tom will discuss in more detail; continued rational industry pricing; and modest incremental improvements in acquisition costs and distribution center efficiency.

Thanks to the dedication of our over 67,000 team members, we continue to aggressively grow our market share. We are very confident we will continue to execute our proven model at a very high level. And based on the strength of our team and our continued confidence in the long-term drivers of demand in our industry, we are establishing our operating margin guidance for 2015 at a range of 18.1% to 18.5%. We are also establishing our earnings per share guidance at $8.20 to $8.30.

January yielded solid results for us, so we feel like we're off to a good start in 2015. And to complete my comments, I would like to commend all of Team O'Reilly for our record-breaking performance in 2014, and their ongoing commitment to our continued success. Because of each of you, 2014 represents the 22nd consecutive year we have increased both our comparable store sales and our operating income, every year our Company has been publicly traded. Thanks to all of you for your excellent work.

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

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

Thanks, Greg, and good morning, everyone. I'd like to begin by congratulating Team O'Reilly on another outstanding quarter and year. Our industry-leading 6.3% fourth-quarter comps, and full-year comps of 6% wouldn't be possible without the excellent, consistent customer service you provide our customers. Your relentless focus on out-hustling and out-servicing our competitors drives our success, and I'd like to thank you for your hard work and commitment.

Today I'm going to discuss our operational results for the quarter and year, and provide color on some of our operational initiatives. SG&A levered 23 basis points for the fourth quarter and 28 basis points for the year, driven by our strong comp performance. At the beginning of the year, we anticipated per-store SG&A would increase around 1.5% for the year, but actual results for the year were an increase of 3%. Early in the year, we made the decision to be more aggressive in our store staffing to capitalize on the favorable industry trends.

As we've discussed on this call many times, we staff our stores to provide excellent customer service and to fuel the growth of our business. Based on our industry-leading comparable store sales results, we feel this decision to be more aggressive was warranted.

When we look at our business, we know we have a tremendous opportunity to improve our average DIY per store volumes. I'd like to touch on two of the items we feel help drive our strong DIY results for the year, and feel that we will continue to drive our business going forward.

First, as I mentioned, we were aggressive in our store staffing hours while also increasing the flexibility of those hours. This allowed us to provide better levels of customer service, especially on nights and weekends, which are high-volume DIY times. Second, we continued to roll out enhanced weekend access to expanded inventories through our DC and hub networks. We began testing this in 2012, and began rolling it out in 2013 through 2014. This enhanced parts availability has been a strong driver to our weekend business.

Based on our results in 2014, we feel we have our store staffing levels dialed in at the appropriate level to provide excellent customer service and drive sales growth. As a result, we expect to see a more moderate growth in average SG&A per store, and are establishing guidance at an increase of 1.5% per store for 2015.

Touching on our distribution team, we successfully opened distribution centers in Lakeland, Florida; Chicago, Illinois; and Boston, Massachusetts during the year. Each of these DCs came online very smoothly, and are now servicing all of the stores in their respective service areas.

With the addition of these three DCs, we are well positioned for expansion in new and existing markets, with capacity for an additional 800 stores across the country. Our ability to provide industry-leading parts availability, while operating very cost effectively, is a big driver of our sales and profitability growth, and I'd like to congratulate our DC teams on a great 2014.

For the year, we accomplished our goal of opening 200 net new stores. We continue to take advantage of new store opportunities across the country, with the most significant growth concentrated in the following regions: the Florida market, supported by our new Lakeland DC; California, as we backfill attractive markets not previously penetrated by CSK; the Upper Great Lakes, as we ease growth constraints across multiple DCs with the opening of the new Chicago DC; and Texas, which continues to be a growing market for us.

For 2015, we expect to open 205 new stores. We will again open new stores across the country with areas of high concentration similar to 2014, and additional growth ramping up in the Northeast, supported by the Boston DC. We've been very pleased with the productivity of our new stores, and believe that 2015 store class will produce another great year.

In closing, I would like to again thank all of our 67,000 team members for your hard work and dedication. Your focus on providing excellent customer service, each and every day, is the reason we had such a successful 2014, and it will be the driver to a great 2015.

Now I will turn the call over to Tom.

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

Thanks, Jeff. I would also like to thank all of Team O'Reilly for your continued dedication to excellent customer service, which drove our outstanding results. Now we'll take a closer look at our results and provide additional guidance for 2015.

For the quarter, sales increased $143 million, comprised of a $100 million increase in comp store sales; a $42 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.

For the year, total sales are $7.2 billion, which represents an annual increase of 8.5% over the prior year, and finished at the top end of our initial revenue guidance of $7 billion to $7.2 billion. For 2015, we are establishing our revenue guidance at $7.6 billion to $7.8 billion.

Our gross margin results of 51.4% this year were very strong, improving 73 basis points, as we were very successful in reducing acquisition costs. However, the impact of our LIFO accounting creates the need for additional color in this area. Our success at reducing our acquisition costs over time 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 cost.

For the year, our gross margin of 51.4% included a LIFO headwind of $41 million. As Greg previously mentioned, our gross margin guidance for 2015 is 51.8% to 52.2%. This guidance assumes that we'll not experience additional LIFO headwinds.

Said another way, we expect acquisition price decreases and increases to be about the same in 2015. To the extent we are successful in gaining net reductions, we will face more LIFO headwinds. However, if this does occur, we would expect a much smaller impact than we experienced in 2014, and our merchandise margins will see a corresponding benefit from the decreased costs.

When we look at our quarterly gross margin, we expect our rate results to be relatively consistent, quarter-to-quarter, in 2015. This means we will see our largest year-over-year gross margin increase in the first quarter due to the significant LIFO headwinds we experienced in the first quarter of 2014.

Our effective tax rate for the year was 36.3%, which was better than our beginning-of-the-year estimate of 37%, as we benefited from better-than-expected job tax credits. When we look at the full year of 2015, we'd expect our tax rate to be approximately 37% of pre-tax income, as certain job tax credit programs have expired. On a quarter-to-quarter basis, we expect our quarterly tax rate to be around 37.3%, with the exception of the third quarter, when we expect a tax rate of approximately 36.2%, as we adjust for the totaling of certain tax periods. These estimated rates are subject to the resolution of open tax periods under audit and our success in qualifying for existing job tax credit programs.

Now we'll move on to free cash flow, and the components that drove our results and our expectations for 2015. For the year, we generated free cash flow of $760 million, which exceeded our beginning-of-the-year estimate of $570 million to $620 million. I will spend some time to discuss the main factors driving our free cash flow results.

Inventory per store at the end of the year was $585,000, which was an increase of 2.6%. We had expected to keep per-store inventory flat from 2013. However, we ended the year with a spike in December DC inventory. For 2015, we expect our per-store inventory to increase a little less than 1% per store.

Our ongoing goal is to ensure we are growing per-store inventory at a lower rate than the comparable-store sales growth we generate. We accomplished that goal in 2014, and expect to continue our success of efficiently deploying inventory in 2015.

Our AP to inventory ratio finished the year at 94.6%. This was substantially better than the beginning-of-the-year estimate of approaching 90%. And this strong improvement, combined with net income over plan, were the main drivers to our better-than-expected free cash flow. In 2015, we expect the growth of this ratio to slow substantially as we approach a yet-to-be-determined ceiling, and are projecting a year-end 2015 AP to inventory ratio a 97%.

For the year, capital expenditures were $430 million, which was above the range we established at the beginning of the year of $390 million to $420 million. This above-expectations result was driven by an increased percent of owned versus leased properties under development for opening in 2015, resulting in the higher investment for these new stores on the books at year-end than we expected.

For 2015, we're setting our CapEx guidance at $400 million to $430 million. The decrease is the result of the completion of our last wave of DC openings, offset in part by the higher mix of owned new stores versus leased. Given these factors, we're setting our 2015 full-year free cash flow guidance at $675 million to $725 million.

This moves us along to our capital structure. Yes, we're still below our targeted debt to EBITDAR ratio of 2 to 2.25 times. During the year, our debt to EBITDAR ratio actually decreased from 1.9 times to 1.7 times. However, we continue to believe our stated range is appropriate for our business.

We will continue to look for the appropriate time to take on additional borrowings and [in our] range, knowing that we remain very committed to prudently managing our debt levels so that we can maintain or improve our investment-grade ratings, which are a critical factor to the success of our vendor financing program.

On this point, we were very pleased by the recent action of Standard & Poor's to raise our corporate credit rating and the ratings on our bonds from BBB flat to BBB plus.

We continue to execute our share repurchase program. And in the fourth quarter, we repurchased 1.2 million shares of our common stock at an average price of $152.05 per share, for a total investment of $179 million. Subsequent to the end of the fourth quarter through yesterday, we repurchased an additional 0.1 million shares at an average price of $183.20 per share, for an additional $9 million investment.

For fiscal 2014, we repurchased 5.7 million shares for a total investment of $866 million. We continue to view our buyback program as an effective means of returning available cash to our shareholders after we take advantage of the opportunities to invest in our business at a higher rate of return. And we'll continue to prudently execute our program with an emphasis on maximizing long-term returns to our shareholders.

For the first quarter, we're establishing diluted earnings per share guidance of $1.89 to $1.93. And for the year, our EPS guidance is $8.20 to $8.30 per share. As a reminder, our diluted EPS guidance for both the first quarter and full year take into account the shares repurchased through yesterday, but do not reflect the impact of any potential future share repurchases.

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

This concludes our prepared comments.

At this time, I'd like to ask Vanessa the operator to return to the line, and we'll be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Seth Basham, Wedbush Securities.

Seth Basham - *Wedbush Securities - Analyst*

Congrats on a great quarter and a very good year.

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

Thank you.

Seth Basham - *Wedbush Securities - Analyst*

My question revolves around SG&A, your leverage for 2015. Seems like you've got the store level staffing dialed in (technical difficulty) for 2015 embeds only about a 10 basis point improvement in the SG&A rate. Why don't you expect better leverage if you expect comps to be 3% to 5%?

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

Tom, you want to take that?

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

Okay. Seth, what I would tell you is that we're looking at good leverage, but we're also looking at making some investments in our business, both from -- primarily around the technology area and communication to our stores. So we have some additional expenses we're going to take on there to ensure that we are providing a customer experience that meets the needs of our customers.

Seth Basham - *Wedbush Securities - Analyst*

Got you. Can you provide any more clarity around that? What particular investments are you referring to?

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

Our ability to enhance our systems and install new systems at a faster rate. And, additionally, the telecom ability to move information, video, things like that, to our stores in a more expedient fashion that will cost us a little more as we set those up, and move away from regular copper phone lines to Voice-over-IP technology and things like that.

Seth Basham - *Wedbush Securities - Analyst*

Okay, great. Thanks. I'll pass it on.

Operator

Michael Lasser, UBS.

Michael Lasser - *UBS - Analyst*

You outlined a lot of the initiatives that help contributed to your above average growth -- or comp growth that you saw in 2014 -- things like the weekend parts availability, weekend store hours, the labor investment. I'm assuming the loyalty card helped.

How far -- if you look at all of those initiatives, how far into them have you really harvested the benefit? So, another way of thinking about it is, how much more can they contribute in 2015? And then, if they're in the eighth or ninth inning, are you just going to be more subject to the ebbs and flows of the overall market demand?

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

Well, Michael, to tell you from my perspective, there's really never been a year in the 30-plus years I've been with the Company that we didn't have initiatives to improve customer service and improve our sales results. The things we talk about now are some things that we've done the last few years, which were a little bit changed from the past, relative to maybe some reservations we had about our relationships with our professional customers, and how aggressive we could be on the retail side.

And in all of those things, we feel like we still have a lot of room ahead of us from an improvement standpoint. So, I would say we're in the early innings in most of those things. Our rewards program, there's a lot of things we can do to tighten the relationships that we have with our customers. Staffing in a retail environment like we're in is always an ongoing challenge, and one in which we feel like we always have opportunity. So, I think we still have a lot of room ahead of us. And as we move through this year, we will be implementing new ideas and new things that we feel like will improve our ability to compete and grow our comp store sales.

Michael Lasser - *UBS - Analyst*

Okay. And my follow-up question, Greg, is when you look at your professional business, is most of the growth coming from existing accounts? Or are you increasing the frequency in the penetration of -- or are you getting more deeply penetrated within your existing accounts -- new or existing?

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

Well, that's a hard thing to measure, obviously, because we're growing as much as we are. But to answer your question as best I can, it's coming from both. Very seldom do you have a relationship with a customer that relates in them buying everything from you. because some things you might not have and you have to pick up, or they may have a brand preference that maybe we don't have, and they buy it from another supplier; or just a variety of things. So we're out there working every day to grow business with existing customers, and we're calling on customers that aren't buying from us, especially in newer markets.

A lot of times, when you start off a new store you work on the low-hanging fruit first, the customers that are most likely to buy from us. And then, over time, as we become more capable and we penetrate deeper into the marketplace, we start developing relationships with other customers. So, it's both; but I don't have a number for you on which would be the biggest contributor.

Michael Lasser - *UBS - Analyst*

Okay. And if I could just sneak one last one in for Tom. Your stock has been a beast. How do you think about continuing to deploy capital back to shareholders through share repurchases when it's trading at the valuation level that it is? And would you consider other forms of capital return?

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

Well, we discussed how we're going to return capital on a quarterly basis, and that's a pretty lively discussion. What I would tell you is that we believe in our long-term growth projections, and we'll continue to execute our buyback program in a prudent manner.

Michael Lasser - *UBS - Analyst*

Okay. Thank you very much.

Operator

Simeon Gutman, Morgan Stanley.

Simeon Gutman - *Morgan Stanley - Analyst*

Nice results, guys. Question on store volumes: so, in the press release, and do the math, the stores are doing about $1.7 million a box. If you just look at your mature store base, which I'm presuming is a bit higher than that, is there a significant spread between some of the better-performing stores and the lower-performing stores?

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

Yes. Our biggest -- our highest volume store would be a -- it's a real high volume store, and it would be well above our average and well above even our heavy metro area averages. Our best-performing stores are typically in large metropolitan areas and take up a significant square footage. And most of them are hub stores or large inventory stores. So, yes, there would be a significant spread between our average store and those larger stores.

Simeon Gutman - *Morgan Stanley - Analyst*

Right, but I guess that's more a function of a location, it sounds, based on your response.

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

Yes, yes. It's the location; it's where they're at; it's the number of shops around them. Our strategy all along has been to position these stores where they are in a position where they can do a lot of DIY business, they are a destination for the DIY customer, yet close to the shops that would be -- most prevalent shops in the area. And then also some of our more -- our older stores or more rural stores, and they would of course be lower volume, so that factors into that, too.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay. And my follow-up, can you talk about private label, particularly your focus in hard parts like brakes and chassis? Are you making -- we know you're making a push, but I think you're making a harder push into the hard part area. And can you talk about the kind of traction you're seeing?

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

Well, again, our private-label products, in the hard parts area, anyway, the product itself in many cases is not much different than the branded product. They are very high-quality private-label products. And our efforts are just to have a little more control of the way the product is managed, keeping it out of our competitors' stores to some degree.

But our private-label strategy is a little bit different than many, in that we're putting high-quality products in the boxes. In many cases, we're using brands that are recognized, in some cases, by the customers, especially the professional customers, as being brands that have been prevalent at some point in the past.

And we do this very strategically and surgically, I would say. We are very careful about what products we put in private-label boxes. And very simply, we carry many, many brands that are just not good brands to move into a private-label box, because the brands are so prevalent and we have excellent relationships with many of our suppliers, and simply want to support their brands. So some of the brands of that we carry -- right now, I would say we would never plan to move those into private label. But others, where the brands aren't as prevalent and it makes sense for us to put them in our own packages, we do that.

But with the key being that we're putting in the box a product that is of high enough quality that our professional customers would consider it equal -- at least equal with the branded product that it may be competing with. So it's a slow-moving strategy. But we're somewhere in the mid-30% range, if we include oils and so forth, in our private-label mix.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay. Thanks, Greg.

Operator

Scot Ciccarelli, RBC Capital Markets.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

Can you provide us a little bit more color on the gross margin expectations? I thought, Greg, you said one thing; and then, Tom, I thought it was a little bit different what you said in terms of the LIFO. It's not clear to me if you guys are looking for improved supplier pricing. And then assuming that we are going to see some lower supplier pricing as part of the expansion expectations for 2015, can you help us better understand where the rest of the gross margin expansion is coming from? Just a little bit more color on that.

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

Our expectation is that we are not going to face meaningful LIFO headwinds in 2015. So the abatement of that is the major mover of our gross margin percentage. We also expect to see more historic incremental improvements in our ability to acquire products, our DC efficiencies, to be the remainder of the increase.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

So on the DC side, though, Tom, how much of the improvement is coming from, let's call it, falling gas and diesel prices on the distribution side? Because obviously you guys run, I don't know, hundreds of thousands of miles if not millions of miles, every year, delivering product to stores, and to customers.

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

Well, what I would tell you is that when we look at falling fuel prices, the major benefit we see is in that DCs. When we look at the stores, our expectation is we're going to run more deliveries. So we offset that rate decrease with more miles. So the DCs are more of a fixed cost, so we do anticipate seeing some benefit. Our expectation is that gas prices are not going to stay this low for an extended period of time.

When we look at DC efficiencies in general, the two main drivers there are reducing excess capacity, especially in the newer DCs, and leveraging those fixed costs. And then just as we grow store unit volumes, the bigger the unit volume, the more efficient the DC is in picking and distributing parts to them.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

Got it. Okay. Thanks a lot, guys.

Operator

Chris Horvers, JPMorgan.

Chris Horvers - *JPMorgan - Analyst*

First, a follow-up to Scott's question. So is there a way to say, I don't know, diesel and gas prices are 3% to 4% of sales, or some percentage of your cost base overall?

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

We don't comment on the portions of our DC expense.

Chris Horvers - *JPMorgan - Analyst*

Okay, fair enough. And then in the Texas market, in Texas you have an above-average exposure. I think 14% to 15% of your stores are in the Texas market. Has that been an outperforming market for you, relative to the comp base of the past few years? And is there anything that you are seeing right now as it relates to an exposure to the oil patch that makes you think that that could be a below-average area for you, going forward?

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

Texas has been a high-performing area for us for a long, long time. Recent -- just from a comp percentage standpoint, because of our growth in other areas, and the stores are maturing in those areas comping at high percentages -- from a percentage standpoint, I would put it kind of middle-of-the-road in our Company.

I think that there's enough growth in Texas, just with population growth in cities like Austin and DFW and other metropolitan areas, that if there is an impact from the gas prices, and maybe some of that business -- or that work slowing down, down there, it's being offset by the population growth. And we've not seen an impact on our business yet.

Chris Horvers - *JPMorgan - Analyst*

Okay. And then finally, in terms of -- how are you seeing -- are you seeing a DIY lift in your business because of the receding gas prices? How is the consumer changing as the money is flowing into their pockets now?

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

Well, our DIY business has been good. For the quarter, our do-it-for-me business was a little bit better, but the DIY business was very good. It's hard for us to know the effect of gas prices on consumer behavior. Although our DIY business was strong for the quarter; it's been pretty strong for the year. So I think that most would speculate, including me, that with gas prices coming down it's going to be good for the consumer. And with tax returns coming up here before long, with decreased weekly spend on fuel, that that's going to be a good thing for our industry and other retailers.

Chris Horvers - *JPMorgan - Analyst*

Thanks very much.

Operator

Alan Rifkin, Barclays.

Alan Rifkin - *Barclays Capital - Analyst*

Congratulations on a terrific year. My first question relates to the DC capacity. With 800 stores still out there, can we rule out a new DC both in 2015 and 2016? Will 2017 be the first time we see another DC added?

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

No, you can't rule out a new DC in 2015 and 2016. We haven't purchased property yet, but we are in the process of planning our expansion. And at the point that we have purchased property, we will announce where our next DC is. But I would speculate that you could expect an opening in 2016.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. Greg, could you maybe provide some commentary on the acceleration of the pro business in some of the newer markets, particularly the Florida and the Northeast, vis-a-vis Boston?

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

Well, I'll start with the Northeast. Those are typically -- or generally speaking, the VIP stores, although we have put a few new stores up there. They're doing great. It's been a big transition up there with the stores having previously been operated as VIP, with shops attached to them. And I think most customers viewing stores as purely retail stores that do both service and parts. And then of course we've had the headwind of convincing some of our professional customers that we're not part of the VIP, and that we're not there competitor, and that we are a great supplier partner for our professional customers. So this past year has been a good year for us. And we've comped really well on the -- in those stores in general. And a big portion of that comp has been on the do-it-for-me side.

In Florida, we've been very fortunate as we've grown down there to have had an incredibly strong team of individuals down there that are very good on the professional side of the business. And I would say that our new store growth down there -- year one, year two, year three -- that a bigger portion of our sales in those stores has been on the do-it-for-me side than would be typical, because of the strength of our team down there on the professional side. So we've been very pleased on the professional side down there.

Alan Rifkin - *Barclays Capital - Analyst*

Okay, thank you. And one last question, if I may, on the guidance. So, you've just had your best EBIT margin growth quarter in a number of years. You've had six consecutive years of 21% earnings growth, or higher. You're guiding to the midpoint Q1 of 19% earnings growth.

As we look at your guidance for full-year 2015, the midpoint would suggest only 12% earnings growth. Is that just conservatism on your part, or do you see something out there in the macro environment in the final three quarters of this year?

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

Alan, this is Tom. When we look at the fourth-quarter expansion and the first-quarter expansion and the year-over-year results, you've got to remember that we've got significant LIFO charges, fourth quarter of 2013 and first quarter of 2014. So when you look at the year-over-year, I'd encourage you to look at the run rate of those.

The second thing I would tell you is we have tough comparisons this year. And if you look back at -- and we feel like our guidance is appropriate. If you look back at last year, I think you would find that our guidance and the growth ratios you talked about are similar.

We're going to go out there and try to profitably grow the business again in 2015. But we feel like the guidance we've given -- reminding everyone that it doesn't include any additional share repurchases -- is appropriate.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. Thank you.

Operator

Daniel Hofkin, William Blair and Company.

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

Great end of the year.

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

Thank you.

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

Just a couple follow-up questions. And you may have addressed this earlier; I dropped off the call momentarily. But the comp in the current quarter, if you will, and your near-term outlook -- you've got gas prices as a tailwind. And perhaps you have a more mild winter as a headwind year-over-year. I'm just curious, how do you see that mixing out right now? Which is the dominating factor? That's my first question.

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

Well, we of course have, as you said, the tailwind of lower gas prices, which should be good. We also have the tailwind of unemployment, which is lowering down, which is good both from a consumer pocketbook standpoint; but also, in our business, from miles driven standpoint, as commuter miles increase.

As we said throughout last year, after we had the tough winter last winter, it's hard to ever really know the impact that has on your business. Although we did see, by category, some of the categories that we would speculate to be affected by harsh weather perform very well, and they continue to.

Our business so far this quarter, as I said, has been good, and we see no reason for that to change. I think the thing that we all need to keep in mind is that the car population being driven in the US today is an older population. And these higher mileage cars, while they are very reliable from an engine/transmission/differential -- or transaxle perspective, and are capable of being kept on the road for a long time, they still require maintenance. And at higher mileages, they require more maintenance. And these aren't catastrophic mechanical failures that would cause the car to be retired, but they are things that can be reasonably expensive.

So I think that those things are contributing to our industry's growth. And I think part of what we all saw it last year, when we had a relatively strong year, was not purely weather-related. It was vehicle age-related, combined with the weather, which is helpful.

So it's hard for me to predict the impact of the consumers having more money in their pocket as a result of gas prices, and employment being a little better, and the effect that maybe milder winter so far. We saw some winter [less] so we'll see what happens. But we're expecting -- we feel confident in the comp store sales range we gave for the year. And like I said, January has started off good for us, so we're hopeful that we'll continue on the trend.

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

Okay. So fair to say that your full-year guidance, if you will, doesn't really assume much either headwind or tailwind from either of those factors. That is your underlying view.

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

Yes. What we do every year is we go through on a by-district, by-region, by-division basis, and evaluate where we're at in the marketplace and where -- what we would expect our growth in those areas to be. And then we consolidate that into our plan. And we're comfortable with a 3% to 5% range for the year right now, all things considered, including those that we've talked about.

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

Okay. And then just one further question, if I might. If you think about the next year or two and potential sources of upside our downside -- you've got obviously continued ramp from CSK, even though we're almost 7 years from the acquisition. DIY sounds like it has further legs to go. Which of those do you think is maybe the bigger potential source of upside, or at least continued tailwind, if you will?

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

Well, I think that we have a long way to go on the DIY side. If you look at the average per-store that we do, compared to our best DIY competitors, we have a lot of upside there. So I would say that's a -- across the board, including a CSK, is probably our biggest contributor.

One of the things that we talk about here a lot is how fragmented the professional side is. And while we feel like we've been a really good professional provider for a long, long time, it's very fragmented; and the percentage of the total business that we have, even though we feel reasonably dominant in many marketplaces.

If you look at the whole US, and the percentage of the do-it-for-me business that we're doing, there's a lot of upside there. So we see a lot of opportunity in both. So I think it would be hard for me to say that there's more opportunity on one side than the other, or in CSK. I think that we're getting pretty reasonably mature out in the Western part of the country. But there's a lot of business out there that we don't have.

I will say that the past couple of years, our do-it-for-me business has grown a little faster than our DIY. And I think for the reasons that have been discussed a lot in the past, relative to vehicle complexity and things like that, that we'll continue to see that trend. Although that trend is somewhat mitigated by our efforts to grow on the DIY side. So I guess what I would say is, we see a lot of opportunity on both sides.

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

Great. Thanks very much.

Operator

Michael Montani, Evercore ISI.

Michael Montani - *Evercore ISI - Analyst*

Wanted to ask, first of all, the loyalty program initiative that you have. The last update I had heard was that there's 9 million cardholders. Can you just refresh that number, give us a feel for the growth rates there? And then, secondly, on hub stores, can you remind us where you are at today? And while there's no DC plans, can you talk about what you might have planed this year for hubs?

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

Well, our loyalty program is now above 12 million customers, and we continue to monitor how we're doing there. And those customers appear to be very loyal to us, and are some of our best customers when you compare their purchases to the average purchases, and so forth. So we're very happy with that program and plan to continue to enhance it.

Our hub store strategy really plays into our DC strategy. Because typically where we put hubs is where we don't have DC service that would put us in a position to where we would have access in our spoke stores or regular stores to a larger inventory.

I don't have a number as far as the number of hubs that we'll add this year, but we consistently add hub stores, and evaluate markets where we might benefit from having access to a larger inventory. And our strategy for a long, long time -- long before they were even called hub stores -- we had these larger inventory stores that serviced other stores from a hotshot delivery standpoint. A customer needed a part, and we made it available through a hub.

We've never used our hubs as replenishment. We've used them only for availability purposes on a same-day basis. And we'll continue to use that strategy, especially up in the Northeast as we expand and we move into markets outside of Boston, for instance, where we wouldn't be able to have enough same-day drops out of our Boston DC to those areas; which there's very dense populations up there, where we'll have to have good access to inventory.

So our strategy, from this point forward, will continue to be as it has been for a number of years: to use hub stores as a means of augmenting our coverage in markets where we don't have a distribution center.

Michael Montani - *Evercore ISI - Analyst*

Great. And just wanted to ask about acquisition costs and CapEx. On acquisition costs, Tom mentioned not to really anticipate further material reductions there. I guess I was a little surprised, just because of the AAP-GPI deal and consolidation between Federated and Pronto, as well as declining commodity costs and potential FX benefits if you're sourcing in dollars. So, can you guys just help us understand what some of the offsets are that we're missing on that front?

And on CapEx, just thinking about the 2 to 3 DCs, I think, that you guys had either opened or retrofitted this year, thinking maybe $30 million, $40 million a pop rolling off CapEx; but, yet, the total should actually increase next year. Maybe just help us understand the cost to build a store that you own versus one that you would lease.

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

Okay. On the acquisition costs, we would expect to make some improvement in our acquisition costs. We've made a lot of headway over the last couple of years. In relation to some of these other consolidations within the industry, they are not sharing their acquisition price changes with us. But we feel like we have, for our volume, very competitive pricing. So we're looking for a more moderate improvement there.

In relation to LIFO, we aren't expecting a large, large number, just some normal acquisition cost improvements. Of course, we'll continue to work at getting the best parts for the best prices to provide value to our customers.

On the CapEx side, the thing that I would remind you is that within the DC development that we opened this year, that stretches back to 2013 when we were purchasing and fixturing those facilities. So it didn't all hit in 2014. And with the cost of a DC can vary, depending on the size and the location, in the $30 million to $50 million range.

Michael Montani - *Evercore ISI - Analyst*

Okay, and just the cost of the leased store versus owned store, because you mentioned that was an offset. Can you just give us some additional clarity on what's actually increasing this year?

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

We're about $1.3 million, $1.4 million for an owned location. And the difference would be primarily -- we might be in the $400,000 for a leased space, assuming it was a white box space.

Michael Montani - *Evercore ISI - Analyst*

Okay, thank you. Good luck.

Operator

And thank you. We have reached our allotted time for questions.

I will now turn the call over to Greg Henslee for closing remarks.

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

Thank you, Vanessa. We'd like to conclude our call today by thanking our entire team for the outstanding year. We are very proud of our strong 2014 results, and remain extremely confident in our ability to continue to aggressively and profitably gain market share, and are focused on continuing our momentum into 2015.

I'd like to thank everyone for joining our call today. We look forward to reporting our 2015 first-quarter results in April. Thank you very much.

Operator

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