THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

ORLY - Q1 2015 O'Reilly Automotive Inc Earnings Call

EVENT DATE/TIME: APRIL 23, 2015 / 3:00PM GMT

OVERVIEW:

ORLY reported 1Q15 sales of $1.9b. Co. expects 2015 total revenue to be $7.6-7.8b and diluted EPS to be $8.42-8.52. 2Q15 diluted EPS is expected to be $2.17-2.21.

THOMSON REUTERS

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

Robert Higginbotham *SunTrust Robinson Humphrey - Analyst*

Alan Rifkin *Barclays Capital - Analyst*

Chris Horvers *JPMorgan - Analyst*

Michael Lasser *UBS - Analyst*

Matthew Fassler *Goldman Sachs - Analyst*

Bret Jordan *BB&T Capital Markets - Analyst*

Dan Wewer *Raymond James & Associates - Analyst*

Simeon Gutman *Morgan Stanley - Analyst*

PRESENTATION

Operator

Welcome to the O'Reilly Automotive Incorporated first-quarter earnings release conference call. My name is Ellen and I will be your operator for today's call. (Operator Instructions). 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 of Finance and CFO*

Thank you, Ellen. Good morning, everyone, and thank you for joining us. During today's conference call we will discuss our first-quarter 2015 results, our outlook for the second quarter and remainder of 2015. 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 estimate, may, could, will, believe, expect, would, consider, should, anticipate, project, plan, intend 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, 2014, and other recent SEC filings. The Company assumes no obligation to update any forward-looking statements made during this call.

At this time I would like to introduce Greg Henslee.

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

Thanks, Tom. Good morning everyone and welcome to the O'Reilly Auto Parts first-quarter conference call.

Participating on the call with me this morning is of course Tom McFall, our Chief Financial Officer, and Jeff Shaw, our Executive Vice President of Store Operations and Sales. David O'Reilly, our Executive Chairman, and Greg Johnson, our Executive Vice President of Supply Chain, are also present.

It is my pleasure to begin our call today by congratulating Team O'Reilly on another record-breaking quarter and a very successful start to 2015. Once again our team's relentless focus on providing consistently high levels of service to our customers generated topline growth which exceeded our expectations and I would like to take this opportunity to thank our over 69,000 dedicated team members for their hard work and unwavering commitment to providing excellent customer service each day in every store across the country. Your steadfast dedication of living the O'Reilly culture is the reason for our consistently strong performance and I cannot thank you enough for your continued contributions to our long-term success.

We established our comparable store sales guidance of 3% to 5% for the first quarter on the heels of the strong demand trends we experienced throughout 2014 tempered by the difficult comparisons represented by the high bar we set in the first quarter of last year. However, we continued to capitalize on the positive momentum throughout the first quarter generating a 7.2% increase in comparable store sales, easily exceedingly the top end of our guidance range.

This strong performance is on top of an excellent 6.3% increase in the first quarter of 2014 and represents our sixth consecutive quarter of comparable store sales increases exceeding 5%. More importantly, our commitment to profitable growth translated these impressive topline results into another record first-quarter operating margin of 18.4%.

Our ability to consistently grow our business profitably is the result of our team's commitment to providing exceptional customer service and our dedication to investing in the tools our team members need to build lasting relationships with our customers.

Overall for the first quarter, sales increased 10% to $1.9 billion and as we have seen over the past year, categories such as brakes, driveline, chassis, ride control and batteries were key contributors to our growth. We view the sustained growth in these key categories as a good indicator of our customers' continued focus on maintaining and repairing their existing vehicles which bodes well for long-term demand in our business.

Availability in these important SKU intensive maintenance and repair categories is critical and our proficiency in delivering parts to our customers faster than our competitors is a key advantage and an important driver in our ability to continue to profitably grow our market share.

These gains, combined with prudent expense control, drove our record 18.4% operating margin which was 180 basis points improvement over first quarter of 2014. Last year's first-quarter operating profit was negatively impacted by a $23 million LIFO charge and by comparison, we saw a smaller but still meaningful $8 million LIFO charge in the first quarter this year.

Tom will discuss these charges in more detail in a few minutes but excluding the LIFO impact from both quarters, our operating profit improved by 92 basis points. This profitable growth yielded a 28% increase and diluted earnings per share which represents our 25th consecutive quarter with earnings per share growth in excess of 15%.

I would now like to take a few minutes and add some color to our comparable store sales results for the quarter. As I mentioned earlier, we generated a very robust 7.2% increase in comparable store sales on top of a strong 6.3% increase in the first quarter of 2014. Sales trends were strong throughout the quarter although they were a little softer in February on a relative basis.

Consistent with what we saw in 2014 both the DIY and professional sides of our business were strong contributors to our comp store growth with professional again slightly outpacing DIY. On both sides of our business, ticket average and traffic count both contributed to the comp growth. As we have seen for the past two years, inflation has not been a driver of our comparable store sales with an inflation tailwind of less than 50 basis points over that period and we continue to expect that we will not see material benefit from inflation in the foreseeable future.

As we have seen for some time now, the growth in average ticket has been driven by increasing parts complexity rather than inflation or pricing which has remained very rational in the industry.

As we build our book of professional business, especially in our less mature markets, traffic continues to be the main driver of our professional comps where we have seen very strong ticket count increases over the last two years. On the DIY side of our business, we also saw solid increase in traffic as DIY consumers recover from the difficult macroeconomic headwinds they have faced in recent years and our internal initiatives focused on our DIY customers continue to gain traction.

Unemployment in the US being down to 5.5% and year-over-year gas prices being down 33% are definitely tailwinds for the business, especially for our DIY customers who have been under significant economic pressure for an extended period of time. To the extent unemployment continues to improve and prices at the pump remain low, we expect our business to continue to benefit. In addition, the primary driver for demand in our business is miles driven and as we saw at the end of 2014 in January miles driven strongly increased contributing to the continued strong demand for our products.

Our second quarter is off to a strong start. However, we are just entering the critical spring selling season and we have experienced volatility in the months of May and June at times in the past. We also face another quarter of strong results from the prior year with a 5.1% second quarter of 2014 comp comparison. Based on these factors, we are establishing our second quarter comparable store sales guidance at a range of 3% to 5%.

Turning to our gross margin results, as I mentioned earlier, the impact of LIFO accounting makes the comparisons to the prior year difficult. Excluding the LIFO charges in both years, our gross margin increased 21 basis points which was in line with our expectations. We continue to realize incremental improvements in our acquisition cost and pricing in our industry remains rational.

Based on these factors, we are leaving our full-year gross margin guidance unchanged at a range of 51.8% to 52.2% of sales. However, we are raising our full-year operating margin guidance from a range of 18.1% to 18.5% of sales to a range of 18.3% to 18.7% of sales.

The increase in our operating margin guidance range for the full year is driven by our stronger-than-expected first-quarter results flow through to the full year. We are also increasing our full-year earnings per share guidance from a range of $8.20 to $8.30 to a range of $8.42 to $8.52. This updated guidance includes the strong first-quarter results and shares repurchased through yesterday and excludes any additional potential share repurchases.

Before I finish my prepared comments, I would like to thank our team for these record-breaking first-quarter results. We remain very confident in the long-term drivers for demand in our industry and we believe our team is very well positioned to capitalize on this demand by consistently providing exceptional service to our customers every day. Again, congratulations to Team O'Reilly for a very strong start to 2015.

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

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

Thanks, Greg, and good morning, everyone. I would like to begin today by echoing Greg's comments and congratulating Team O'Reilly on another outstanding quarter. I couldn't be more proud of our team's execution and the level of consistent top-notch service that we continue to provide to our customers day in and day out.

7.2% comparable store sales growth doesn't happen by accident especially when it sits on top of a 6.3% increase in the prior year. Our industry-leading performance is the direct result of our team's commitment to out-hustling and out-servicing the competition each and every day. Our team once again rolled up their sleeves and executed our proven business model delivering another quarter of record-breaking results.

I want to thank each of our team members for their continued hard work and dedication to making O'Reilly Auto Parts the destination location for all of our customers' auto parts needs.

As Greg mentioned earlier, we are not just focused on topline growth, rather we are laser focused on building long-term win-win relationships with our customers which results in sustainable, profitable growth.

During the first quarter, our team did a great job of profitably gaining market share and at the same time kept a close eye on store and distribution center expenses. For the quarter, SG&A levered 71 basis points on extremely strong comparable-store sales and excellent expense control. Average per store SG&A increased 2.7%, which was higher than we originally expected for the quarter and was driven by higher than planned store payroll, commissions and incentive compensation and exactly what we want to see when we have such strong sales and profitability results.

Our Companywide compensation philosophy is focused on instilling within each of our team members the mentality that they should run the business like they own it and they did exactly that during the first quarter. When we generate strong topline results, we expect average SG&A per store to increase while at the same time generating impressive expense leverage and this is what we did in the first quarter.

Although our first-quarter average SG&A per store was slightly higher than planned, when we float these results into the full-year, we don't anticipate a material impact and as such, we still expect our full-year increase in average SG&A per store to be approximately 1.5%.

We successfully opened 67 new stores during the quarter and we continue to be pleased with the performance from our new stores. As we discussed on our last call, we will open new stores across our footprint with more significant growth concentrated in Florida, supported by our new distribution center in Lakeland, Florida; in California as we backfill attractive markets not previously penetrated by CSK; in the upper Great Lakes, as we freed up capacity across multiple DCs with the opening of our new Chicago DC and in Texas.

Speaking of Texas, this has been a growth market for us for many years and we see opportunity for continued profitable growth in the state in the future. However, at this point, we are butting up against our distribution capacity. As Greg mentioned earlier, we are extremely focused on investing in the tools that give our team the ability to provide consistent top-notch service to our customers. To that end, we are excited to announce we have acquired property in Selma, Texas where we plan to build our 27th distribution center.

Selma is a northeastern suburb of San Antonio so we will refer to it as our San Antonio DC and it is about an hour away from Austin. Both San Antonio and Austin are metro areas with rapid growth and the new DC will allow us to open more stores and improve our parts availability in both of these substantial markets. When the new DC opens, it will also free up much-needed capacity at both our Dallas and Houston DCs allowing those facilities to operate more efficiently while also creating capacity for future growth.

The San Antonio DC is planned to open in the second quarter of 2016 and will have the capacity to service approximately 225 stores. As we have proven in the past, our distribution operations team is extremely effective at planning, building and opening new distribution centers and we are confident that this project will roll out with the same degree of efficiency that our past projects have delivered.

I would like to finish up today by thanking our store and distribution teams for their relentless focus on providing consistent top-notch customer service each and every day. Your hard work and dedication continues to drive our success.

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 on another outstanding quarter.

Now we will take a closer look at our first-quarter results and update our guidance for the remainder of 2015. For the quarter, sales increased $174 million comprised of a $122 million increase in comp store sales, a $50 million increase in non-comp store sales, a $3 million increase in non-comp non-stores sales and a $1 million decrease from closed stores.

For 2015, we continue to expect our total revenue to be in the range of $7.6 billion to $7.8 billion. Our gross margin results of 51.9% for the quarter were in line with our expectations. On a run rate basis, gross margin improved 20 basis points over the fourth quarter primarily based on better distribution leverage on higher sales. On a year-over-year basis, gross margin improved 109 basis points. However, as Greg mentioned earlier, this comparison is skewed by the impact of our LIFO accounting. As we have discussed over the past year and a half, 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 cost.

For the first quarter of 2015, we experienced a LIFO headwind of $8 million compared to a headwind of $23 million in the first quarter of 2014. Excluding both of these headwinds, year-over-year gross margin rates increased 21 basis points. As we look forward to the rest of the year, we expect to continue to see moderate LIFO headwinds as we incrementally approve acquisition costs. However, we remain comfortable with our gross margin guidance of 51.8% to 52.2% of sales.

Our effective tax rate for the quarter was 37% which was slightly better than our expectations of 37.3% and was driven by the realization of more job tax credits than originally expected. When we look at the full-year 2015, we still expect our tax rate to be approximately 37% of pretax income. On a quarter-to-quarter basis, we expect our quarterly tax rate to be around 37.3% for the second and fourth quarters with the third quarter expectation of 36.2% as we adjust for the tooling 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 will move on to free cash flow and the components that drove our results in the first quarter and our updated guidance expectations for the full year of 2015.

Free cash flow for the quarter was $315 million and we are revising our full-year guidance for free cash flow to a range of $700 million to $750 million reflecting an increase from our previous range of $675 million, to $725 million as a result of the strong operating income results in the first quarter.

Inventory per store at the end of the quarter was $570,000 which was a 2.5% decrease from the end of 2014. Our ongoing goal is to ensure we grow per store inventory at a slower rate than the comparable store sales growth we generate. We definitely accomplished that goal in the first-quarter. However, this decrease is primarily timing as a result of the very strong sales during the quarter and we are actually a little lighter on inventory than we would like to be. For the year, we continue to expect our per store inventory to increase a little less than 1% per store.

Our AP to inventory ratio finished the first quarter at 97.7%. The spike in this ratio is also related to the extremely strong sales during the first quarter. For 2015, we continue to expect the year-end AP to inventory ratio to be around 97%. Capital expenditures for the first quarter were $91 million which is a little less than we had planned but we still expect our 2015 CapEx to be within the range of $400 million to $430 million inclusive of the San Antonio DC.

Moving on to debt, we finished the first quarter with an adjusted debt to EBITDA ratio of 1.7 times, still well below our targeted ratio of 2 to 2.25. We continue to believe our stated range is the appropriate amount for our business and we will move into this range when the timing is appropriate.

We continue to execute our share repurchase program and year to date we have repurchased 1 million shares of our stock at an average cost of $210.74 per share for a total investment of $210 million. 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 high rate of return. We will continue to prudently execute our program with an emphasis on maximizing long-term returns to our shareholders.

For the second quarter, we are establishing diluted earnings per share guidance of $2.17 to $2.21. Based on our above plan results in the first quarter and additional shares repurchased since our last call, for the full-year we are raising our guidance to $8.42 to $8.52 per share representing an increase of $0.22 per share from our previously announced guidance.

As a reminder, our diluted earnings per share guidance for both the second quarter and full-year taken into account the shares repurchased through yesterday but do not reflect the impact of any potential future share repurchases.

Finally, I would like to once again thank the entire O'Reilly team for their continued dedication to the Company's success. Congratulations on an outstanding start to 2015.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Robert Higginbotham, SunTrust.

Robert Higginbotham - *SunTrust Robinson Humphrey - Analyst*

Thanks. Good morning, everyone. My first question is really around trying to gain some clarity around your guidance. I am a little confused about what is driving the incremental margin expectation given your sales range is unchanged, your gross margin is unchanged. That would seem to imply that you are expecting better expense performance yet your per store expense guidance is the same. Could you help me connect those dots a little bit better?

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

Sure, Robert, this is Tom. The increase in our operating margin guidance for the year is based on the performance in the first quarter with the second, third and fourth quarter expectations staying the same.

Robert Higginbotham - *SunTrust Robinson Humphrey - Analyst*

I guess I am still a little bit confused because all of your annual numbers are the same except for your EBIT margin and yet your SG&A per store for the year is the same as well. I might need to dig into this off-line. Is there something else I am missing about timing of store openings perhaps or something along those lines?

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

No, I would tell you that some of the ranges have -- there is varying degrees within the ranges based on our first-quarter results. The only percentages that we felt triggered outside of our range was operating margin.

Robert Higginbotham - *SunTrust Robinson Humphrey - Analyst*

Got it. And then my second question is one of your big competitors this week talked about some supply chain issues they were having with one of their undercar vendors. You don't necessarily overlap with all of your competitors in terms of vendors but did you experience any of those same type disruptions?

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

There is really not, there is seldom a time that we don't have some type of supply chain disruption. And I don't know for sure the vendor that they were speaking to. I don't think they mentioned the name but I suspect I know because we are supplied by the same vendor and we actually have a couple of vendors that are having trouble as a matter of fact, Greg Johnson, who is here visited one of their distribution centers here recently just to kind of get a better bird's eye view and handle on what they're doing to fix this.

We mitigate that significantly with relationships with backup vendors, many of which supply us other products and then we have processes in place to defer orders to vendors who have product and can supply. So I'm sure they will get through this in short order. They are a quality company and one that has supplied us for a long time. But they are in the process of integrating some business that they obtained into distribution facilities that don't appear to be as prepared for it as they could have been and we are experiencing some disruptions. But again, this is not something that is unusual. We consistently have issues of one type or another with suppliers.

Robert Higginbotham - *SunTrust Robinson Humphrey - Analyst*

Got it. Let me sneak just one more quick one in there. You spoke to February being a little bit soft. Your footprint in the Northeast is not particular big at this point but was it snowstorm, inclement weather type issues that drove that February softness? In the Northeast specifically?

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

Again we are not as exposed in the Northeast as some. Really what I was talking about was it be more on a relative basis, our two-year stack was pretty consistent. We went up against some tougher comparison February but our two-year stack stayed consistent but the comp number for this year was slightly lower than it was in January and March.

Yes, I would say it was more related to kind of some late winter weather which in the longer term is generally good for us but in the short term when people are iced in and not driving and those kind of things, it can create some softness in business for a short period of time. I think that was probably the primary factor with this year in February. Again, we had a good February. It was just slightly less than what our January and March was.

Robert Higginbotham - *SunTrust Robinson Humphrey - Analyst*

Got it, thanks.

Operator

Alan Rifkin, Barclays.

Alan Rifkin - *Barclays Capital - Analyst*

Thank you very much. Greg, you mentioned that traffic was the main driver on the DIFM side of the business. I was wondering if you could maybe drill a little deeper into that. Is the traffic being driven by existing customers or new customers? Maybe if you will provide an update as to where you are seeing new customer acquisitions go in the future?

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

Alan, it is both. We continue to do well with existing customers. We are doing a lot of work to do more business with some of our national customers and I guess to speak to your question about our work with existing customers, we have a significant effort as do our competitors to do more business with national accounts and competitors that are chains of shops. And we continue to do well and expect to continue to do well in the future.

A big driver of our transaction increase is the continued opportunity we have in some of our newer markets and specifically the West Coast markets as we continue to gain traction out there and become more of a first call status or maybe move ourselves from third call to second call with some existing customers. And then also new customers as we continue to expand our professional programs in the stores that we acquired from CSK years ago.

We still -- and I know we are a years down the road now but we still have a lot of runway in front of us as far as the amount of business that we can be doing out there per store on the professional side as well as the DIY side. And we have seen some really good results in the last several months out there on both the professional and the DIY side.

Alan Rifkin - *Barclays Capital - Analyst*

Okay, thank you. One follow-up if I will. Specific to Florida and South Florida, would you be able to provide some commentary on what you are seeing down in that region? How many stores do you have down there now? What will it grow to? Given what I believe is the huge success in Florida, do you think that the Lakeland DC can ultimately support the 300+ stores with the volumes that you are likely to get?

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

Yes, I think we can. Florida continues to be an incredibly good state for us and is a big growth state for us in the first quarter. We are up to 130 stores in Florida now. We have not really reached down into the far South Florida although we continue to look at property down there and work on our expansion down there. But we are incredibly pleased with our performance down there.

A lot of this is about the team that we have executing our plan down there and we just have a really strong team in that part of the country as we do many parts of the country. But down there they have just proven that they are very successful at executing our business plan and looking back, I wish we would have expanded into Florida several years ago because it has been a great market for us.

But we continue to look to that growth into Southern Florida as a big opportunity for us and have no reason to believe at this point that we won't be in good shape from a distribution standpoint out of our Lakeland facility.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. Thank you very much.

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

Thank you, Alan.

Operator

Chris Horvers, JPMorgan.

Chris Horvers - *JPMorgan - Analyst*

Thanks. Good morning, guys. Wanted to follow up on that question. So they push into these markets whether it is California or Florida or the Northeast really touching all of your competitors, some more than others. But can you talk about what the competitive response has been on the pricing side, is the share sort of equally being felt between your national public competitors versus let's say wholesale distributors?

Finally, the competition for the parts pros and the store managers, as you add stores in these regions, where are you sourcing that talent from?

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

Okay. Well, from a competitor standpoint, we've got tough competitors all over. I would tell you that the competitive landscape from our perspective is at least as strong as it has ever been and probably stronger since more of our competitors compete on both sides of the business than they did just five or 10 years ago. It's hard to know for sure where the business that we gain and market share gains come from but I would say it is a mix of both.

We have good competitors that are publicly traded, good competitors that are private, good competitors that do business as what we call two-step distribution which is kind of off the beaten path type of under car warehouses and they can be very strong competitors. We really focus on establishing a relationship with the best customers in a market and then over time every customer in a market and just working our way up the ladder and proving our ability to provide service that exceeds our competitors in many cases having competitive prices. We really don't see a big price response as we come into a market. I think that most in our industry have realized that price is not the primary reason that a shop buys from a parts store, it is service and relationships and their ability to work with a part supplier to make sure that they have the right to return products that they take off a car for warranty, the occasional labor claim. Just all the relationship things that go into helping partner with those guys to be successful in their businesses.

From a people standpoint, we sometimes transplant people. We will move them from on market to another. In many cases we will hire them from competitors who are doing a lot of business down there. Many times they are not our retail publicly traded competitors, they might be our wholesale competitors or under car type competitors. But as we expand into new markets we of course look around and see who is selling the parts and if we have a chance to give someone an opportunity with a company that is going to grow in that market and put them in a position to improve their career and become part of our team here at O'Reilly, we do that.

But in many cases we are able to move people from within as we expand and in Florida, it has been a mix of both. We have hired some people that have helped us and then we have developed and promoted some people from within. So it is a combination.

Chris Horvers - *JPMorgan - Analyst*

And then as a follow-up, on the national account side, is that a relatively new push for you in sort of what was the genesis of it and what capabilities perhaps now that you have now that you didn't have before allow you to do there or is it just a question of a priority?

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

Prior to us acquiring CSK and getting CSK to the point that they are as professionally capable as they are today -- and I'm speaking of our West Coast stores -- we really didn't have the national footprint to be a true national account provider. Today we are in a better position than ever to do that with the exception of a few states up in the northeast.

Some of these accounts are not truly coast to coast national accounts. They are big regional accounts and over the past three, four, five years, we have put a lot more effort into developing relationships with those accounts and growing those accounts than we had in the past partly just because of our geographic footprint. But then also because of the consolidation in the service provider industry and our desire to benefit from that consolidation and be a partner with these companies that are consolidating and growing their business.

Chris Horvers - *JPMorgan - Analyst*

Thanks very much.

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

Thank you.

Operator

Michael Lasser, UBS.

Michael Lasser - *UBS - Analyst*

Good morning. Thanks a lot for taking my question. I was really just mostly curious about what has caused the step function change in your performance relative to the industry? Seemingly in the last couple of quarters, for sure this quarter, last year you had seen a little less SG&A leverage in your P&L and you were investing a little bit more in the stores. So are you now seeing the benefits of that through maybe accelerated market share gains or is it the weather and gasoline phenomenon that you are seeing whereas your competitors aren't seeing any? We all know that you folks work very hard but we also assume that everyone else works hard so where is the delta?

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

Well, it is hard to know for sure, Michael, but we try awfully hard. We have a great team in the field and they are supported by a great team here at our headquarters. I can't help but feel like some of the things that we have done over the past few years which have improved our availability to products, we have increased the number of times that we touch a store each day. As you know, product availability is a huge factor in driving the success in auto parts business simply because if you can get the part faster than your competitor can, that is a big factor.

I think some of the retail things we have done as far as improving the services that we do, maybe helping a customer pull the meaning of a check engine light that is on or installing a wiper blade or the occasional battery, stuff like that. I mentioned before that there was a time that we were pretty reluctant to do those kinds of things simply because we didn't want to infringe on our professional customers' business and operations. But over time have realized that those kinds of things for the most part they were unable to charge a customer for anyway and they didn't mind us doing those things so we have done that. I think that has been a contributor to our DIY business.

As much as anything, we just got a really, really strong management team in the field that is incredibly focused on making sure that we out hustle and provide a service level to our customers that is greater than what our competitors do. While that is not something that the day you start doing that, it grows your business instantly, it is something that over time has a very positive effect and I think that over the past two or three years we put a renewed emphasis on the importance of out servicing our competitors and making sure our customers experience a service level with us that is greater than they would experience with any of our competitors. And I think that that is probably the biggest factor driving our performance.

Michael Lasser - *UBS - Analyst*

Okay. And if you had to quantify where you are availability in store service today versus where you were two years ago, is there any way you could do that like number of parts or percentage of stores that are being touched multiple times per day?

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

Well, two years ago we would have been -- we are maybe slightly better than we were two years ago, compared to three or four years ago, it is significantly better. We started touching our stores more on weekends back about three years ago. I don't really have the numbers with me but we turned it up a lot and we can turn it up more. As more and more of our competitors came to the realization that being in the professional business requires that you be able to put the part in the professional customers' hand first if you want the business as they have augmented their

THOMSON REUTERS

distribution capabilities with hub stores and so forth, we have further levered this very strong distribution network we have that is augmented by our hub stores and we have the ability to lever it further if we want to.

Right now we feel like the service levels that we are able to provide are a notch above our best competitors and we have the ability with this strong infrastructure that we have to continue to turn that up as we need to to remain the preferred supplier and maintain this advantage that we feel like we have from an availability standpoint.

Michael Lasser - *UBS - Analyst*

That makes sense. Last one with all due respect, I guess the only part of your organization that may not be working to its full potential is the balance sheet. I would expect Tom's comment that you will take your leverage ratio up from 1.7 times to 2 to 2 -- (inaudible) when the time is right. But can you give some factors that we can better understand what is going to dictate that timing? Is it a gauge, the performance of the business, are you keeping that powder dry in the event that things slow and you will be able to cushion your earnings with that or is it are you waiting for stock price to get to before you take your leverage up because stock seems to be only going one way right now.

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

Michael, this is Tom. I guess you are asking me that question. We are a long-term focused Company so how much we repurchase during a quarter is a portion of our long-term plan. When we talk about the quarter itself, we really look at our buyback as call to call. If we look back to the beginning of the year, we were in the dark period until we released earnings in February and we bought really not very many shares. So since the last call, we have repurchased $200 million worth of shares so a pretty good amount. What I would tell you is we continue to be very effective in generating free cash flow higher than our conservative projections. So we will continue to deploy the cash that we generate over a period of time to consistently buy back our shares with an eye that we want to maintain flexibility to pursue opportunistic acquisitions.

Michael Lasser - *UBS - Analyst*

Could one of those acquisitions be akin to what you did with CSK where it was a sizable entity not operated to its true potential and you've been able to fully exercise every bit of value from it?

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

There is not a player in the US that we don't have a significant overlap that is of that size. We continue to look at all opportunities to expand our brand. But to your point, our history has been we have been successful at identifying underperforming assets and bringing the things that we do to the table and improving their performance so that is what we continue to look for.

Michael Lasser - *UBS - Analyst*

Thank you so much and good luck.

Operator

Matthew Fassler, Goldman Sachs.

Matthew Fassler - *Goldman Sachs - Analyst*

Thanks a lot. Good morning and congratulations on your results. I want to dig into your history and the business and think about the way you have typically seen gas prices impact sales, both in terms of magnitude, mix and also timing and what you see today and how that compares to your expectations and your prior experience?

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

Well, we have seen the impact from gas prices really more on the increasing side as they increased back some years ago and we felt the effect of that to some degree although it was tempered by the fact that people were hanging onto their cars longer in the tougher economy and maybe doing more repairs and that benefited us.

I guess what I would say is that right now with gas prices having come down as much as they have, the feeling in the business is very robust and it is hard to quantify that. I would say that the magnitude of the effect of that I would reflect simply in the miles driven and toward the end of last year, miles driven increased significantly. If I have my number right, I don't have it in front of me but I think in January miles driven were up 4.9% and that is pretty significant. So to me the measurement of the effect of miles driven in gas prices is reflective of miles driven and miles driven of course is a very positive effect on us.

Now one of the contributors to miles driven of course is the fact that unemployment rates have come down and commuter miles are up and we view that as a positive for us too. So both those things are significant contributors we feel like to our business as well as many retail businesses that might not do as well when consumers don't have cash and might defer some of the things that they would otherwise do.

Matthew Fassler - *Goldman Sachs - Analyst*

I know you spoke about strength in some of the core auto parts businesses. To the extent that you have a discretionary element in your mix, have you seen that respond recently to what might be deeper pockets for your core customer?

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

What I would say is during the tougher times, during the recession, we saw some of the appearance, accessory type categories that performed poorly and this past quarter virtually every category performed well. So yes, I think our category performance is reflective of a consumer that is willing to spend more money than we have in the past few years.

Matthew Fassler - *Goldman Sachs - Analyst*

Great. Just one quick follow-up. I know you touched on a couple of different markets. If you think about regional differences across the business, anything significant other than say the strength of Florida that you discussed?

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

Had a lot of strength in Florida, have a lot of strength on the West Coast we are doing real well. Really all parts of the country we had a really good start to the year. West Coast and Southeast were our best-performing markets.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. Greg, thank you so much.

Operator

Bret Jordan, BB&T.

Bret Jordan - *BB&T Capital Markets - Analyst*

Good morning. When you are talking about areas for geographic expansion, we didn't talk much about the East and I guess if we look at the Devens distribution center, what are we serving out of there? And are you focused elsewhere because there are just better opportunities there than what you are seeing in the Northeast or maybe a little more color on that.

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

We are working to expand up there now. Devens is supplying somewhere in the area of 60 stores, just slightly over 60 stores which include the 56 VIP stores that we acquired a few years ago. We were actively spending a lot of time up there to find expansion properties and we will be expanding up there. We see a lot of opportunity in the Northeast, high population, a lot of traffic. We will do well. It is just a matter of us obtaining sites and growing which we are in the process of doing so that is, there is a good opportunity for us there.

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

Bret, this is Tom. In last quarter's call, we commented on this that 2016 would be a big year for us up there. Typically for us to get comfortable with the markets and develop sites and really get the process rolling is a two- to three-year process so next year we would expect to see more significant growth out of Devens.

Bret Jordan - *BB&T Capital Markets - Analyst*

Okay, great. Thank you. And then a quick follow-up, you had commented that the second quarter is starting strong. Could you remind us the cadence last year? I think my recollection was Q2 last year started stronger and ended weaker and just sort of a softer, June and July. Is that something that you see and I guess as you progress through the quarter?

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

Okay, yes, the difference wasn't significant. Last year April and May were pretty comparable, June was slightly softer but it was pretty consistent month to month.

Bret Jordan - *BB&T Capital Markets - Analyst*

Okay, great. Thank you.

Operator

Dan Wewer, Raymond James.

Dan Wewer - *Raymond James & Associates - Analyst*

Greg, O'Reilly's success in the do-it-yourself channel seems to be overlooked. When we've been out visiting stores of late we sense that you have been adding payroll to the stores after 5 PM and on the weekends. Is that having any benefit that you can tell on your do-it-yourself productivity?

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

We think it does. We think that there was a time not that many years back that we were probably guilty of not staffing the way we should on nights and weekends just with respect to our focus on the professional side of the business and the fact that we wanted to have our best and most qualified team members present when the shops were open. And as we have tried to improve the service levels that we provide on the DIY side, one of the keys to that of course is to staff appropriately when a lot of the DIY business takes place which is on nights and weekends. So we have had a concerted effort over the past couple of years maybe a little more than that, to staff more robustly on nights and weekends not only from headcount perspective but with the quality of team members that can provide the service levels that will make us the preferred supplier to a DIY customer.

Dan Wewer - *Raymond James & Associates - Analyst*

And then also can you speak to the change in your private label penetration over the last three or four years and then also if there is any payback on that on the commercial sales channel because we do sense that some commercial customers are focusing a bit more on price than they have in the past?

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

Our private label business continues to grow. I actually didn't look at the number before I came here. I think we are around 35% private label something like that. We have grown that really through the recession with respect to the fact that more customers were choosing or driven to choose a low price product as opposed to a premium product and where we had coverage disparities, maybe we had a -- our full line coverage in a brand and then we had short line coverage in a private label we felt like it was putting us at a little bit of a disadvantage. So we have expanded our private label product offerings in many hard parts categories and as a result, that availability has shown us that a lot of customers simply prefer those products.

Now in our business -- Tom was saying something to me and I will get back to it.

In many of our categories where we have put a private label product in place, it is actually a branded product, it is a product that we have set up as a brand, a national brand that we consider to be a private label product. We would expect that to continue to grow to some degree. Like our import parts offerings are for the most part what we would consider private label but they are really branded products. So yes, we expect that to continue to do well and grow.

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

What I would add to that is when we look at our professional business, we manage our product lineup on a category by category, segment by segment basis and there have been certain categories that professionals have been more receptive to moving off of traditional brands. But there are many more categories where brand and that traditional brand remains extremely important for the installer.

Dan Wewer - *Raymond James & Associates - Analyst*

So you would say that the growth in your private label is primarily driving the do-it-yourself business for our O'Reilly, not so much commercial?

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

I would say that what we are saying is it is really a category by category basis from what is accepted in the general marketplace.

Dan Wewer - *Raymond James & Associates - Analyst*

Great. That is very helpful. Thank you.

Operator

Simeon Gutman, Morgan Stanley.

Simeon Gutman - *Morgan Stanley - Analyst*

Greg, you got a couple of questions with market share in it. I want to focus on that for a second. Do you have a sense whether you are taking more share in DIY or DIFM at the moment?

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

Well, I would speculate and again we don't have all the details of the division of sales by our competitors. But based on what we know at least in our publicly traded competitors, they appear to be growing their do it for me business much faster than their DIY. Both ours are growing well but considering the disparity that we seem to have between our DIY performance and some of our competitors DIY performance, I would have to think that we are gaining more market share on the DIY side.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay, that is helpful. Second, AAP is going through a consolidation and I think there is some natural and expected fallout and I think you would agree with that. Can you say whether you are positively surprised when you are using more fallout than you would expect or less? Is that something you can share with us?

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

I think they are still fairly early in the integration process. I think that we have been pleased with our ability to grow business in the markets where they have worked to consolidate, some markets they really haven't done much consolidation work yet. But I would say that we are pleased and it has gone kind of as we would have expected from a benefit to our Company standpoint. I think there is still a lot to be seen with their integration, it is still in the early stages I would speculate. And a year from now I could probably speak to the benefit we have seen and whether or not that met our expectations better than I can at this point simply because the integration is still very early.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay, thanks for the color.

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

Thank you.

Operator

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*

Okay. Thanks, Ellen. We would like to conclude our call today by thanking the entire O'Reilly team for the outstanding start to 2015. We remain extremely proud of our record-breaking first-quarter results and are extremely confident in our ability to continue to aggressively and profitably gain market share and are focused on continuing our momentum throughout 2015.

I would like to thank everyone for joining our call today and we look forward to reporting our 2015 second-quarter results in July. Thanks.

Operator

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