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Brian Sponheimer *Gabelli & Company - Analyst*

PRESENTATION

Brian Sponheimer - *Gabelli & Company - Analyst*

So our next presenter continues to set a standard for the industry that really only they have been able to surpass, with continued same-store sales growth in the mid- to high-single-digit range. Just an outstanding operator that continues to drive not only operating profit dollars, but expand margins and use that cash flow to both grow their footprint and buy back shares, all of which they've done at a very smart-- that has been smart from a valuation range because, ho-hum, every year O'Reilly has gone up. And this year it's no different with the stock up about $50 year to date.

The Company has about 100 million shares and trades around $260 for about a $26.7 billion equity cap. About-- what I'd I do?

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

I asked Tom if we traded again at the $260.

Brian Sponheimer - *Gabelli & Company - Analyst*

$262.47 was not too long ago.

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

Yes.

Brian Sponheimer - *Gabelli & Company - Analyst*

$1.1 billion of net debt. $27.8 billion to enterprise value.

We're delighted to have Greg Henslee, the Company's CEO; Tom McFall, the Company's CFO; and Jeremy Fletcher with us today. We will go right into Q&A. And I thank the gentlemen for coming.

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

Thanks, Brian.

So we wanted to do our standard deck and they didn't want us to, so we're just going to answer questions. You guys have seen the deck before, I bet.

Brian Sponheimer - *Gabelli & Company - Analyst*

I think at this point few in here don't know who you are.

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

Oh. Okay.

Brian Sponheimer - *Gabelli & Company - Analyst*

Let's just talk about the industry in general. We've heard-- the fundamentals continue to be relatively similar to what we've seen over the course of the last three years. Maybe just talk about some of the puts and takes that you see from an industry fundamental basis as we roll through the next couple of years.

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

Okay. Well, I think some of the positives are that miles driven's done a good pace of increase during the last year or so. The gas price is down. The economy seems to be doing a little better in general. And of course the average age of cars continues to increase, which I think we're all kind of learning for the first time what it means as cars get this old in the United States and, from our perspective, it's very positive.

Cars have proven to take more maintenance and it's the kind of maintenance that people are willing to invest in, because it's not engines and transmissions and differentials that might cause one to decide whether or not they keep the car or whether or not the car should be scrapped or continued to be driven. It's the kind of maintenance that people are willing to invest in because the car has a good drive train and a decent interior and decent exterior and things like that. So, we see that as very positive and we feel like the industry has a lot of tailwinds for that reason.

On I guess the other side, things I think of from a macro perspective, there's always the threat that fuel prices could increase abruptly because of some macroeconomic thing and that, as history has proven, hits miles driven pretty quick. And when that happens, that affects our business and others in our business.

The complexity of vehicles I think is a positive from the perspective that each repair costs a little more money. It's a negative from the perspective that it takes more training on behalf of technicians that work on cars to be able to work on cars. And that's one of our industry's biggest challenges is making sure we have a population of technicians that are able to work in the shops and work on cars that are very computer managed and sensor managed. And that's a pretty big change from back a few years ago, but it's one that we've kind of evolved into. The big challenge now, of course, is just making sure that we continue to force the OEs, because they're unwilling for the most part to do it voluntarily, to provide the aftermarket the information that we need to train our technicians to be the repair specialists that consumers typically expect.

Brian Sponheimer - *Gabelli & Company - Analyst*

I think it's been undeniable that you've gained a significant amount of market share just by virtue of your comps over the course of the last five years. We're seeing two competitors change how they think about distribution and investing heavily. How do you-- one, how do you continue to gain share if [first-store delivery] rises at some of your main competitors and, two, in the event that price is used as a differentiator, how do you hold price to maintain operating profit dollars?

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

Yes. Well, we've always had good competitors. I've been with O'Reilly for 31 years. And I remember back 31 years ago the store that I ran was a-- we had tough competitors back then. I mean I fought every day for the business that we did. And today we've got 4,550 store managers out there fighting for business. No customers on the wholesale side give us their business because they think we're this great company or they think that we deserve it because the trade rags recognize us as a leader and all that kind of that stuff. They give it to us because we have store managers that are out there working hard to provide the service levels that allow the shops to be more successful. And we support them with a distribution system that allows them to have the part and say yes; in many cases, more than our competitors.

So, it's a combination of high service level, strong relationships, professional parts people. And it's an ongoing battle. There's no day that we wake up and we feel like that we've got this book of business that's for sure coming to us. We feel like we have to go out and earn it every day. And that's what we say to our store managers and that's what they go out and do.

I think that over the next 5-10 years the competitive landscape's going to change. We'll have new competitors. I think that with AutoZone and Advance beefing up their distribution infrastructure to make availability less of an advantage for companies like us and GPC and others, I think we'll have new competitors because I think they're putting pressure on some of the independent aftermarket players. I think that some of the gains that Advance and AutoZone have had is they've stepped up their distribution and inventory they deploy in their stores. I think they've taken some business away from the more independently-owned part of the aftermarket and I think they'll continue to fall under pressure. And those of us like the NAPA stores and our stores and some of the strong two-step undercar locations, we're in good shape to compete I think with whoever the competitor is and it looks like that's going to change over time.

Brian Sponheimer - *Gabelli & Company - Analyst*

How much of your recent growth is measurable in such a way that you can see that some of the CSK stores that you acquired in 2008 and 2009 have now reached full maturity where they have first call with their target markets, with the sellers?

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

Yes. Well, the CSK stores have done great. I don't think we really have any that we would say are-- I think it's-- it's really hard to say that any of our stores are at full maturity. We've got a competitor in every market. And store managers would never say to me or to Jeff Shaw, our operations guys, that they think they've got all the business they can get in that market. I mean that's just never the case. If we thought that, we'd jump in the car and I'd run over the shop and say, well, why is there NAPA invoice on this guy's desk, because there would be. You hardly ever have all of a shop's business.

The CSK stores have ramped up well. Those stores are doing what we would expect them to do from a volume standpoint. We certainly can and will do more business out of what was the old CSK stores, but we're not nearly where those stores can eventually be and will be over time. But I don't think we'll ever get to a point to where we say, yes, those stores finally got there and we're there. It's an ongoing piece of work.

Brian Sponheimer - *Gabelli & Company - Analyst*

You all have done a terrific job driving operating profit dollars through both sales growth and in taking costs out. The one piece of this business, or really aftermarket in general, that's been missing is price. What's it going to take to see some price inflation absent some of the more commodity-based items that you sell, where we can really see that be the-- where inflation really helps drive that profit dollar?

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

Yes. One of you guys want to take that or do you--?

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

It would be great to see some top-line inflation to help comps and to help gross margin dollars. As an industry we've done a good job of taking costs out of the supply chain and reducing acquisition costs, branded versus private label, where parts are manufactured. So that's helped to sustain our gross margin comp dollars. So our expectation is that next leg of gross margin expansion from a dollar standpoint will be through the top line as we see inflation driven by some wage pressures as the wage-- unemployment market tightens and interest rate increases. We get a lot of questions about our supplier financing and that's just an input cost. So to the extent we saw increasing interest rate, we'd expect to see that come through in price; not just for us, but for us and our competitors. We've been good as an industry at passing along those price increases.

QUESTIONS AND ANSWERS

Brian Sponheimer - *Gabelli & Company - Analyst*

Any in the audience? Just don't want to hog all the time here.

Sure. One second.

Unidentified Audience Member

Is there any kind of relationship between your short-term borrowing costs and the cash flow multiple where you wouldn't be willing to buy stock?

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

We look at our long-term expectation of cash we're going to generate on a discounted basis to figure out if we think that we should continue to buy our stock. Our expectation on our buyback is we're going to grow on a long program and consistently buy shares back over time.

Unidentified Audience Member

You couldn't translate that into, looking at it right now, a multiple (inaudible)?

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

I'm sure there's some multiple we wouldn't pay. I'm not sure that we would talk about what that number was.

Brian Sponheimer - *Gabelli & Company - Analyst*

Go ahead.

Unidentified Audience Member

Hey, Greg, just because it's timely, the telematics, could you talk a little bit about what's going on as far as the OEs trying to keep that vehicle in their service network, communicating, and maybe what the aftermarket's doing in response to that?

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

Sure. Well, in the last few years some of the manufacturers have put devices on cars. It's called telematics. It's basically a device that uses in some cases cell technology, in some cases the satellite technology, to move information about the car. So if a car has certain failures, or just any conditions that the device is geared to report, this device reports that to the-- right now to the original equipment manufacturer. Many of you are driving vehicles that are a late enough model that you probably have telematics on it.

To date the OEs have not given the aftermarket that information and access to that information. So myself and Bill Rhodes, Darren Jackson, Tom Gallagher and Stu Crum with Bridgestone and Firestone, we're on a-- we formed a board some time ago called the CARE board, Coalition for Automotive Repair Equality. And that's the board that pushed through the agreement that we have with the OEs called Right to Repair that requires that they give the aftermarket information about diagnostic codes and other things that are necessarily to repair a car.

So, we have that in place, but we don't have either legislation or an agreement with the OEs on the use of telematics. And our position is that if a consumer is paying for this device, which they pay for when they buy a car, they should be able to control where that information goes. It should not just go to the OE dealer. Maybe the OE wants to take the position that they're going to require it comes to them for quality standards or whatever they may claim, which is legitimate, but they should-- the consumer should also be able to choose another entity that they want that data to go to, or more than one entity. And in our case we believe that that would in many cases be aftermarket automotive repair shops.

And so we're working together now. Matter of fact, we had a fundraiser this morning with our suppliers to help us fund the effort that we're putting into negotiating a deal with the OEs to give the aftermarket access to that information. It's very important for the future. We're years down the road before this will be an issue, but if we don't take action now it will be an issue at some point that we will wish that we had dealt with, so we're taking action in advance of it becoming a consumer issue.

Brian Sponheimer - *Gabelli & Company - Analyst*

(Inaudible).

Unidentified Audience Member

Hey, Greg, one of your vendors decided to go in and buy up businesses that are similar but not as quality as yours. What's your reaction to that channel cluster-- clutter or the confusion or crossover?

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

Yes. Well, I call it--.

Unidentified Audience Member

I'm talking about Carl Icahn Enterprises.

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

Yes. Yes, I call it-- I think the word you used first was the word I would use, a cluster.

Unidentified Audience Member

This is a family network.

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

(Laughter) Okay. Well, we're not real happy about it. It's hard for us not to feel like that we're competing with a supplier to some degree, even though they've divided the companies and so forth. To the extent that they are-- or that he's simply going to buy some aftermarket WDs and operate a business and there will be no advantage to them on the items that Federal-Mogul supplies the aftermarket, then maybe over time it'll prove not to be an issue. But I think that me and others that are managing companies in the aftermarket today are concerned and a little suspicious. And I think that maybe some of the behaviors of Federal-Mogul following that acquisition have caused us to have a little more concern.

So, it's not a positive thing from our view. There's really not been any businesses bought that any of us would have had interest in I didn't think to this point, but the fact that one could surmise that we're competing with a supplier is a little bit uncomfortable.

Unidentified Audience Member

How long did-- you say CSK is two different brands? It is what now, five years? Four years?

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

No. You mean since we bought CSK?

Unidentified Audience Member

Yes.

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

No, we bought them in 2008 so it's been a little over seven years.

Unidentified Audience Member

Seven years.

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

Yes. They were converted and renamed between 2008 and 2010, yes.

Unidentified Audience Member

Okay. But you have different brands there. The one up-- I forget the name--.

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

Well, there's actually four.

Unidentified Audience Member

Oh, there's four.

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

There was the-- yes, there's Checker, Schuck's, Murray's and Kragen. Yes.

Brian Sponheimer - *Gabelli & Company - Analyst*

Mike.

Unidentified Audience Member

Thanks. I wanted to ask about the loyalty program. There was some good data that you guys had shared at the Investor Day. Can you update us on the number of individuals? And what's their behavior been like either in spend or frequency of visit versus the non-loyalty?

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

Yes.

Unidentified Audience Member

And then just a follow-up for Tom.

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

Well, we've got almost 19 million customers that are signed up and active. I don't have all the numbers with me to give you the specifics on what they buy, but I can tell you that they're our best retail customers. The average of their ticket is higher than the typical average.

It's hard for us to know how many of those customers were already our best customers before we signed them up on loyalty, so there's really no way to surmise whether or not the behavior that we observe under the loyalty program is due to the loyalty program or was something we already had, but we do know our retail comparable store sales are doing pretty good. And our loyalty program's been in place now for a couple of years and we're happy with it. And the behavior of those customers is positive. They buy more. They tend to be more medium-type do-it-yourselfers, not just light do-it-yourselfers, so the tickets are bigger in many cases. So, it's been a real good thing for us.

Unidentified Audience Member

And then just for Tom, on the cost side, just given what we've seen from Walmart in terms of wages, how are you all managing through employee salaries per hour? And then also on Affordable Care Act. How are you able to manage your healthcare expense?

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

Okay. So when we look at minimum wage, there are some cities that have already passed high minimum wages and we've adjusted. When we look nationally, we don't have a lot of team members that are in those lower pay grades. Our desire is to find people that have the passion for customer service and the inclination for mechanical devices and get them in and promote from within. So most of our folks are above that amount. So I think if we look long term at big changes in minimum wage, our expectation is that that'll be an input cost across the board with us and our competitors and will get passed through in price.

The second part of the question was--?

Unidentified Audience Member

On the healthcare side.

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

Healthcare. A couple of years ago, for those of you who watch our team member account, we increased the mix of part-time people we have in the stores for jobs that may made sense to be part time. And we've decreased that number somewhat, but we have faced higher medical costs like the rest of the retailers out there. From our perspective it's been a good mix change for us in that it allows us to snap better on the DIY side.

The Affordable Care Act continues to change and modify in form. Our number one focus is to make sure that we have the right staff, the right parts professionals that are full-time folks that deliver great service and drive revenue. And manage healthcare costs, but we can't let that run our business.

Brian Sponheimer - *Gabelli & Company - Analyst*

If I could ask one about growth, at your Analyst Day you talked about having about a five- and six-year run rate of being able to add 200 stores from a greenfield perspective. We just saw Bridgestone bid for Pep Boys and it could be argued that there could be 560-plus retail outlets that may be available. How would you I guess handicap the risk versus reward in something like VIP where you've had some success in that sort of service and retail model versus what may become available -- my speculation only -- with these retail outlets?

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

Yes. Well, as you're recognizing, we don't know yet what's going to happen with that, but we've been pretty happy with how the VIP thing played out. Initially there was a lot of concern over us sharing space with the shop and the other shops in the area's perception of that sharing and their interpretation that it may mean more than just real estate sharing; it may mean that we have a partnership that would cause our other customers to believe that we were really their competitor in the service business. So we've been very careful about that. And frankly, as we made sales calls up in Maine where we bought these stores, really that's been the first comment that was made is, well, yes, but aren't you guys partnered with VIP? And we've had to explain kind of what the situation is there, that we simply share real estate.

VIP's a little unusual because those stores were not big enough to create the demising wall that you would ideally have in a situation like this. We share a corridor where they have kind of waiting room and then we control when the store opens and closes. But sharing that corridor creates even more of that conversation. But once we've overcome that issue and everyone understands-- the shops that matter understand that we're not in partnership with them, we've done really well. As I said on our call, our comparable store sales in the VIP stores are outstanding percentage-wise. We're on a small base and growing, but percentage-wise it's really good.

I think when it comes to Pep Boys, if that opportunity were to come up we would evaluate it just as we would any other opportunity in due course and see if the location, or any locations, made sense for us and determine internally if we were comfortable with dividing the stores and creating a demising wall in the likelihood that you could find double and stuff like that. Really, Pep Boys' business model is a lot different than ours. So if that opportunity came up, it would be strictly just a real estate thing, does that space work for us or not. And if they were doing zero volume that'd be fine to start because we would do it a conversion of their volume to the kind of volume we do anyway.

Brian Sponheimer - *Gabelli & Company - Analyst*

Going back just to typical O'Reilly growth, you guys are putting in a large DC in San Antonio and you've highlighted at least a number of states that you don't have at the present that you [quite want] yet. So maybe just talk about what you see from a growth trajectory there.

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

Yes. Well, Texas is growing like crazy. There are people moving there all the time. So we're opening the distribution center in San Antonio, really to not only take advantage of what we see as an opportunity to do more business in San Antonio and north into Austin, because they're both markets that are growing incredibly fast, but we've been a little bit of a victim of our success in Texas and, by virtue of that, we have simply overloaded our existing distribution network. We do more volume out of those DCs than we really should be doing and can do efficiently. So San Antonio will offload some of the load that we have on Houston and DFW, and Lubbock to some degree, and allow us to operate more efficiently and put ourselves in a position to grow in those markets. Because we have opportunities in those markets to grow and we simply don't right now to the extent that we could because of the distribution capacity that we lack, which San Antonio solved.

And then, of course, we need to have better distribution up in the Northeast. And we're expanding our Greensboro distribution center and then we'll be looking for distribution sites on north, probably in Pennsylvania, up in that area, and then we'll plan our next one from there depending on where we end up.

Brian Sponheimer - *Gabelli & Company - Analyst*

Tom, leverage is a quality problem for you. You've had a target leverage that just keeps getting pushed away because you generate so much cash. Maybe talk about how you view the balance sheet now versus at any other point.

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

This is specifically why we brought Jeremy.

Jeremy Fletcher - *O'Reilly Automotive, Inc. - VP Finance and Controller*

Nothing's really changed in how we think about leverage from when we set our target initially. You referenced it. We're further ahead on operating cash flows than we would have expected. From a working capital standpoint we're further ahead. Our priorities remain the same for how we're going to use our cash and reinvest it back in the business. And we've talked about growth and that it's going to be a priority. Would invest it in acquisitions, but we're a very cautious buyer. We are only going to pay what we feel like is a good value for those.

So it really kind of goes back to what's the best use of cash and how we balance that. And Tom spoke to it earlier. It's really-- executing the buyback program is about consistency and being in it for a long period of time. And it doesn't make a lot of sense to push faster than what we've seen because of the impact it has on how the rating agencies think about us and then, quite frankly, just not being able to maintain the consistency in a buyback program that we think is the real icing on the top of the cake from a long-term standpoint.

Brian Sponheimer - *Gabelli & Company - Analyst*

Would your ability to-- or does your ability to generate cash change how you look at acquisitions from a real estate standpoint to maybe just being able to use that cash now to actually buy the underlying box, too?

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

Would we look at the actual real estate property itself?

Brian Sponheimer - *Gabelli & Company - Analyst*

Right.

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

We would always-- we don't move a lot of stores. We don't close a lot of stores because half of our business is about being in the right location and half is about being in the general right areas. We historically haven't closed a lot. So our long-term return is much better if we own the dirt and that's our goal. Now, in most locations, or in a lot of locations, maybe it's very densely populated and we're in a strip center, an existing building. Maybe we can't convince the landlord or the owner of the property that they should part with it, but our preference is to own the real estate.

Brian Sponheimer - *Gabelli & Company - Analyst*

Any others in the audience? We've got about one minute to go.

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

We exhausted them.

Brian Sponheimer - *Gabelli & Company - Analyst*

Yes. You work fast. I mean just keep doing what you're doing, guys. Thank you so much for being here.

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

Okay.

Brian Sponheimer - *Gabelli & Company - Analyst*

Thank you, guys. Appreciate it.
