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

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Matthew Fassler  Goldman Sachs - Analyst
Dan Wewer  Raymond James & Associates - Analyst
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PRESENTATION

Operator
Welcome to the O'Reilly Automotive Incorporated fourth-quarter earnings release conference call. My name is Adrian and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later we will conduct a 30-minute question-and-answer session. Please note this conference is being recorded.

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

Tom McFall - O'Reilly Automotive Inc. - EVP and CFO
Thank you, Adrian. Good morning, everyone, and thank you for joining us. During today's conference call we will discuss our fourth-quarter 2015 results and our outlook for the first quarter and full year of 2016. 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 statement 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.
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 and Greg Johnson, our Executive Vice President of Supply Chain are also present.

It is my great pleasure to congratulate Team O'Reilly on our incredible performance in 2015. We had simply an outstanding year. Our fourth-quarter comparable store sales increase of 7.7% completes a year where we generated comparable store sales increases in excess of 7% all four quarters and generated an industry-leading annual comparable store sales growth of 7.5%.

These outstanding results are the direct result of our team of over 71,000 dedicated team members earning market share by providing consistently excellent levels of customer service.

Our considerable 2015 market share gains are even more impressive when one considers our four consecutive quarters of 7+% comparable sales growth comes on top of our strong 2014 results when we generated comparative sales growth in excess of 5% each quarter and a 6% comparable store sales growth for the full-year of 2014. This consistently robust topline performance is the direct result of our team’s dedication to living the O'Reilly culture of providing incredible levels of service to each of our valued customers and I want to thank each of our team members for their continued contribution to our Company’s long-term success.

For the fourth quarter, we robustly grew sales by 10.5% and for the full year, we generated 10.4% total sales growth. With our focus on growing sales profitably and controlling our expenses, we generated a fourth-quarter operating profit of 18.6%. For the full year, we generated a record operating profit of 19% which was a 140 basis point improvement over 2014.

During the quarter we generated earnings per share of $2.19 which represents an increase of 24% over the prior year. This quarter represents the 28th consecutive quarter we have grown EPS in excess of 15%. For the year, we generated EPS of $9.17 a share which was an increase of 25% over the prior year. This year represents the seventh straight year we have generated annual EPS growth in excess of 20% and I couldn’t be more pleased with our team’s consistent efforts all the way down our income statement starting with the always critical topline driven by our team’s effort to provide unsurpassed service and earn our customers’ business year after year.

When we look at our sales performance for the quarter, it was relatively consistent on a month-to-month basis. November was a little slower on the DIY side of the business as the warmer than normal temperatures across many of our winter-sensitive markets created a headwind to some of the cold weather-related categories. However with the onset of colder temperatures, we were able to capture this deferred demand in December and finish the year on a high note.

The composition of our comparable store sales growth in the fourth quarter was very similar to the whole year. Both our professional and DIY sides of the business were strong contributors to our comparable store sales growth with professional being slightly higher. Increases in comparable transaction count and ticket average contributed equally to our growth with a larger contribution from our professional ticket count although our DIY ticket count growth continues to be strong.

The increase in average ticket continues to be driven by the secular industry driver of parts complexity with no help from increases in selling price as inflation remains muted.

Our performance for the quarter as we have seen over the past year and a half was driven by key hard part categories such as brakes, driveline, chassis and batteries. Through November, the latest data available, miles driven were up 3.5% year to date representing 21 straight months of year-over-year increases. We feel this positive trend driven by low gas prices and improving employment has been an important factor in fueling our robust comparable store sales growth.

For 2016, we expect to see positive tailwinds from continued modest improvements in total employment and low gas prices which will continue to support further increases in miles driven and demand in our industry. Although at a lesser degree on a year-over-year basis compared to the significant tailwinds we had in 2015.
We also remain extremely confident in our team’s ability to provide industry-leading customer service and gain market share and our first quarter is off to a solid start. However, after generating comparable store sales gains of 7.5% and 6% the last two years, we face difficult comparisons on a two- and three-year stack basis.

Taking all these factors into account, we are establishing both our first-quarter and full-year comparable store sales guidance at 3% to 5%. We will exclude the additional Leap day from our 2016 comparable store sales when we report our first-quarter results and have accordingly excluded it from our sales guidance ranges.

We are establishing our full-year 2016 operating profit guidance at a range of 19.3% to 19.7% of sales. The increase over the prior year is driven by further gross margin improvements and reduced legal costs which Jeff and Tom will discuss in more detail.

For earnings per share, we are establishing our first-quarter guidance at $2.41 to $2.51 and for the full year, our guidance is $10.10 to $10.50. Our guidance includes all the shares repurchased through this call but does not include any future share repurchases.

Before I finish up my prepared comments, I would like to again thank our team for our record-breaking 2015 results. We remain very confident in the long-term drivers for demand in our industry and we believe we are very well-positioned to capitalize on this demand by consistently providing industry-leading service to our customers every day.

Again, congratulations to Team O’Reilly for their record year and the great start we have to our first quarter through this point in February.

I will now 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 my remarks by congratulating Team O'Reilly on our phenomenal execution in 2015. Our team members take a lot of pride in O'Reilly Auto Parts, our culture and our customer service. With the 7% plus comparable store sales growth we generated in all four quarters of 2015, there is certainly a lot to be proud of.

Once again, our team's focus on providing top-notch customer service allowed us to generate comparable store sales that led our industry.

For the quarter, we grew total revenues 10.5% and total gross margin dollars by 12.7%. For the year, we grew sales by 10.4% and gross margin dollars by 12.2%. Our ability to generate sustainable, profitable growth is the direct result of our ability to provide exceptional service, a wide product offering at competitive prices and superior parts availability. This growth doesn't happen without the dedication of our store, DC and office support teams.

Now we will spend a little time talking about our SG&A expense in 2015 and our outlook for 2016.

For the fourth quarter, we levered SG&A by 41 basis points and 55 basis points for the year both driven by our extremely strong sales results. As a reminder, included in the second quarter of 2015 was an adverse judgment in a long-term dispute with a former service provider which negatively impacted our full-year SG&A by 24 basis points.

Looking ahead to 2016, we expect SG&A leverage to benefit from the comparison to this item and more modest leverage on sales guidance that is not as robust as the extremely strong sales we generated in 2015.

At the beginning of 2015, our guidance for the increase in average SG&A per store was 1.5%. Well, we came in at a 2.8% increase which is in line with our expectations given our extremely strong sales performance. With comparable store sales of 7.5% versus our beginning of the year guidance of 3% to 5%, our SG&A exceeded our expectations driven by higher variable compensation at every level, higher variable costs associated with the increased customer accounts, and as we have discussed on previous calls, our commitment to aggressively staff our stores to take better advantage of the favorable market conditions.
Looking forward to 2016, we expect per store SG&A to grow at approximately 2% for the year. This is a little higher than our typical expectation of 1.5%. Three areas that are raising our expectations are higher expected medical costs, a somewhat more aggressive advertising campaign and additional investments in our internal information systems capability.

As we saw in 2015, this is our current plan but it could change as we will continue to prudently manage SG&A expenses both up and down based on ongoing sales trends and the opportunities we see in the marketplace. For the quarter, we opened 48 net new stores including our first two stores in Connecticut and achieved our goal of opening 205 new stores for the year. Opening new stores is a long process that involves every area of our Company and I would like to thank the entire team for their outstanding job in opening 205 great stores during 2015.

As we discussed on our last call, our plan is to open 210 net new stores in 2016. We will open stores all across our footprint, 38 states in all. Areas of concentration will be Texas as the new San Antonio DC will free up much-needed capacity across our existing three Texas DCs; the upper Great Lakes, as we continue to leverage capacity added with our new Chicago DC; Florida, as we continue to expand south with the support of our Lakeland DC; the Western half of the country as we continue the long process of backfilling markets; and the Northeast, as we begin ramping up openings in New England supported by our Boston DC. Also in 2016, we will begin the planned expansion of our Greensboro, North Carolina DC adding 200,000 square feet which will allow additional capacity for growth as we backfill those markets.

I would like to finish up today by very quickly talking about our recent annual managers conference held in St. Louis earlier this month. Each year we get all of our store managers, district managers, regional managers and divisional vice presidents as well as our sales and DC management team members together in one place at one time to build leadership skills, enhance product knowledge and share best practices across our Company.

The theme of this year’s conference was committed to service, then, now and always and it perfectly summarized how our current and past success has been built on our unwavering commitment to our customer and how our future is dependent on continually identifying, mentoring and promoting the next-generation leadership to live the O’Reilly culture of customer service. This conference always serves as a great springboard for the new year and this year’s conference was the best one yet.

I will close my comments by again congratulating Team O’Reilly on their strong performance in 2015. Our team set the bar high this past year but we can never rest on our laurels. Every day we must provide unwavering customer service that surpasses expectations and continues to earn our customers’ business. 2014 and 2015 were great years for our Company and I am confident that we have the team in place to roll up our sleeves and out-service our competition taking market share in 2016.

Once again, great job Team O’Reilly. Now I will turn the call over to Tom.

Tom McFall - O’Reilly Automotive Inc. - EVP and CFO

Thanks, Jeff. I would also like to congratulate all of Team O’Reilly on another outstanding year.

Now we will take a closer look at our quarterly results and provide some additional guidance for 2016.

For the quarter, sales increased $185 million comprised of a $134 million increase in comp store sales, a $52 million increase in non-comp store sales, flat non-comp non-store sales and a $1 million decrease from closed stores.

For 2016, we are establishing our full-year total revenue guidance at a range of $8.4 billion to $8.6 billion.

For the quarter, gross margin was 52.7% of sales and improved 103 basis points over the prior year. This exceeded our expectations as we benefited from the mix of sales and leverage on distribution costs driven by the strong sales offset in part by minor LIFO headwinds. For the year gross margin was 52.3% of sales, an improvement of 85 basis points over the prior year. This is slightly above our beginning of the year guidance of 51.8% to 52.2% as we benefited from better than expected acquisition cost improvements and leverage on distribution costs offset in part by full-year LIFO headwinds of $28 million.
Looking forward to 2016, we expect gross margin to be in the range of 52.3% to 52.7% of sales. The improvement is the result of lower expected LIFO headwind and annualization of cost — excuse me — of acquisition cost improvements from the last year partially offset by pressure on DC leverage. We also assume pricing in the industry will remain rational.

Our effective tax rate for the year was 36.2% of pretax income. Excluding the third quarter non-typical tax reserve adjustment related to a previous acquisition, our effective tax rate met our expectations. Looking at 2016, we expect our tax rate to be approximately 36.7% of pretax income with the increase driven by the comparison to the favorable prior year non-typical tax reserve adjustment.

On a quarterly basis, we expect the rate to be relatively consistent throughout the year with the exception of the third quarter when we adjust our tax reserves for the [tooling] of open tax periods. These estimates are subject to resolution of open audits and our success in qualifying for existing job tax credit programs.

For the year, free cash flow was $867 million which is $107 million increase from the prior year driven by increased income partially offset by a lower decrease in net inventory. Our guidance for 2016 is $750 million to $800 million which is below our strong 2015 results as we expect a decrease in our net inventory investment on a year-over-year basis will be less offset in part by our plan increase in net income.

Inventory per store at the end of the quarter was $576,000 which is a 1.5% decrease from the end of 2014. Our ongoing goal is to ensure we grow per store inventory at a lower rate than the comparable store sales growth we generate and we definitely accomplished that goal in 2015. However, part of the 2015 decrease in per store inventory is timing related to our very strong 2015 sales. And accordingly for 2016, we expect our per store inventory to increase approximately 1.5%. This growth rate is still below our comparable store sales growth and we expect to continue our success of effectively deploying inventory.

Our AP to inventory ratio finished the fourth quarter at 99% which was an increase of 4% over the prior year as we benefited from incrementally improved terms and high sales volumes. For the year ended 2016, we expect an AP to inventory ratio of approximately 100% as we incrementally improve our vendor terms but face the headwinds of lower expected sales growth.

Capital expenditures for the year were $414 million which is right in the middle of our guidance. For 2016, we are forecasting CapEx at $460 million to $490 million. The increase is driven primarily by more new stores, a higher mix of owned stores, newer stores tending to be in higher cost areas and store technology infrastructure upgrades.

Moving on to debt, we finished the fourth quarter with an adjusted debt to EBITDA ratio of 1.52 times, still well below our targeted range of 2 to 2.25 times. We are pleased to report that during the quarter our rating with Moody’s was increased to Baa1 as our debt ratings are critical to our overall capital structure. We continue to believe our stated range is appropriate for our business and we will move into this range when the timing is appropriate.

We continue to execute our share repurchase program and from the date of our last conference call through today, we repurchased 1.5 million shares for an aggregate investment of $398 million at an average share price of $252.88. Since the inception of our buyback program, we have repurchased 51.8 million shares for an aggregate investment of $5.5 billion at an average share price of $106.10.

We continue to view our buyback program as an effective means of returning available cash to shareholders after we take advantage of opportunities to invest in our business at a high rate of return and we will prudently execute our program with an emphasis on maximizing long-term returns to our shareholders.

As Greg mentioned earlier, our EPS guidance for the year is $10.10 to $10.50. Our guidance includes all the shares repurchased through this call but does not include any future share repurchases.

One point I would like to add, we will see some lumpiness in our year-over-year comparisons. The comparison in the second quarter will benefit from the 2015 charge for the adverse judgment in the long-term dispute with a former service provider and the comparison in the third quarter.
will suffer from the 2015 favorable non-typical tax reserve adjustment related to a previous acquisition. These two unusual items net out the full-year comparison but will create some noise in the second and third quarters.

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

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

**QUESTIONS AND ANSWERS**

*Operator*

(Operator Instructions). Tony Cristello, BB&T Capital Markets.

**Tony Cristello - BB&T Capital Markets - Analyst**

Thank you. Good morning and thank you for taking my call. First question I had was when you look at the quarter and the comp, very strong, were there any geographical differences that you saw and are those trends still as robust as you entered into the first quarter here?

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

Throughout the year, we've had some geographical differences which are typically tied to better comp percentage growth in our expansion markets and less comp percentage growth in our older more established markets. And yes, I think we would still be on that same kind of trend line geographically as we enter the first quarter.

**Tony Cristello - BB&T Capital Markets - Analyst**

And as a follow-up, has the robust environment allowed your maturity or ramp time to close? Are you getting to a faster maturity of some of your newer stores because of just the demand or is it sort of still DIY and it takes longer to get to commercial?

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

As typical, DIY is the business that you gain fastest primarily location-based when you are looking at do it for me business, it takes a while to build those relationships. As far as quicker to maturity, that is a hard question to answer. Obviously in good environments like we had in 2015, our new stores start at the high end of our expectations and that is saw in 2015. Where ultimately they mature to, we are not going to lower our expectation so we continue to see great opportunities for our new stores but they are performing very well.

**Tony Cristello - BB&T Capital Markets - Analyst**

Would you say that the store base in general is half or two-thirds mature and the other third being newer? Is that a good characterization?
Greg Henslee - O'Reilly Automotive Inc. - President and CEO

Really, Tony, we don’t think of any of them as being mature from a market share perspective. What I would think of as being a mature store would be those stores in the five-, six-year age range. And Tom, what would that be half -- it would be maybe not quite half our stores, something like that.

Tom McFall - O'Reilly Automotive Inc. - EVP and CFO

The CSK stores that we bought in that acquisition for primarily the do it for me, we had a lot of opportunities to build them and still do so we consider most of those markets to be immature. So about half.

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

But, Tony, what I was saying, we just came back from our annual store managers conferences that Jeff was talking about and while we have many stores in many markets that have been in place for a long time and would be considered mature just from the time they have been opened, we have tons of opportunity to grow sales in those stores and I promise you the goals that those stores set are not goals that would be reflective of what someone would typically think of as calls for a mature store.

Tony Cristello - BB&T Capital Markets - Analyst

That is great. Thanks for your time. Great quarter.

Operator

Matthew Fassler, Goldman Sachs.

Matthew Fassler - Goldman Sachs - Analyst

Thanks a lot, good morning, gentlemen. How are you? A couple of questions. So your sales guidance looks to be consistent through the year. While you didn’t guide to first-quarter EBIT margin relative to the full-year EPS margin, it looks like the implied earnings growth in the first quarter is stronger than the implied earnings growth for the year. And I know that share count is probably a small piece of that because the buyback would have a bigger impact percentage wise on Q1 at least with what you have bought back to date.

But anything in particular that would give you more visibility on EBIT margin in Q1 versus the year as a whole such that the implied EBIT margin would be up a lot more for the first quarter?

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

Great question, Matt. When we look at our LIFO charges from last year which are associated with our improved acquisition costs, they built throughout the year so when we look at the first quarter, we have the biggest year-over-year gross margin improvement based on the build of those improved acquisition costs.

Matthew Fassler - Goldman Sachs - Analyst

What kind of swing from LIFO do you expect to see in Q1 in particular?
Greg Henslee - O'Reilly Automotive Inc. - President and CEO
We had minor amounts of LIFO expected this year which is similar to how we did the plan last year. If you give me one second, I will --

Matthew Fassler - Goldman Sachs - Analyst
Should we really think about the year ago number and this related compare rather than this year's delta in Q1 that would make a difference?

Greg Henslee - O'Reilly Automotive Inc. - President and CEO
Yes, I would look at gross margin as being relatively consistent throughout 2016.

Matthew Fassler - Goldman Sachs - Analyst
Got it. That is helpful. And then secondly, you talked about supply chain and there is obviously a laundry list of DCs that you have built out and continue to build out and it sounds like in the comp range that you gave you would expect that that would not be a tailwind for you this year. What kind of comp do you need this year to leverage supply chain versus what you would need in a typically or where you maybe have a little less distribution maturing?

Tom McFall - O'Reilly Automotive Inc. - EVP and CFO
What I would tell you is that we had awful good fuel prices all year and what happens with fuel prices will be a key to what that is. Within the comp range that we have, 3 to 5, we feel comfortable we would be able to create some leverage on DC expenses in a normal year but obviously in 2015 we have very difficult comparisons and very low fuel costs.

Matthew Fassler - Goldman Sachs - Analyst
And have you marked your assumptions to spot which is obviously about as low as it has been in quite a long time?

Tom McFall - O'Reilly Automotive Inc. - EVP and CFO
We make assumptions that -- obviously the first quarter assumption is easier to make than fourth-quarter assumption but given that they are historically low, we would expect them to rise somewhat over the year.

Matthew Fassler - Goldman Sachs - Analyst
Understood. Thank you so much.

Operator
Dan Wewer, Raymond James.
Dan Wewer - Raymond James & Associates - Analyst
Thanks. Good morning, Greg. During the past year, you have talked about looking for acquisition opportunities, a great track record with CSK as an example. Now with Pep Boys apparently going to Icahn Enterprises, how are you thinking about acquisition opportunities either in the US or maybe Canada or Mexico?

Greg Henslee - O'Reilly Automotive Inc. - President and CEO
We continue to look around. We are opportunists when it comes to acquisitions but at the same time we go out and kind of seek out potential acquisitions as we expand in the new markets or sometimes even consideration backfilling in some markets.

So we continue to look for something that is a good fit for us. We obviously would like to acquire someone that made sense to us up in the Northeast. Pep Boys while it wasn’t a perfect fit, the parts side of it would have been somewhat of a fit although the price got to a he point that we didn’t have interest obviously. But yes, we want to acquire companies that make sense for us. We continue to look for that and we would consider companies that were outside the US as long as they were in countries that we felt like we wanted to do business in.

Dan Wewer - Raymond James & Associates - Analyst
Is there anything significant left?

Greg Henslee - O'Reilly Automotive Inc. - President and CEO
Yes, up in the Northeast, there are several companies up there. I won’t run through the list of names because I don’t want them to feel like I’m trying to chase them down or anything but there is a lot of companies up there doing business. And we would be interested in some of those that are good geographical and good business model fits for us.

There are still chains that are not publicly traded that are 400 stores and several in the 100 to 200 range and some less than that that our high-quality family-owned businesses.

Dan Wewer - Raymond James & Associates - Analyst
This is an unrelated question, can you remind me what O'Reilly is doing in the way of global sourcing, I guess particularly as you grow your private label business? And then related to that with the strengthening of the US dollar, is there expected to be any margin benefit I guess if said that would kick in later in 2016?

Greg Henslee - O'Reilly Automotive Inc. - President and CEO
We do globally source several products as really all of our competitors do for instance in brake rotors and brake drums, there literally is not a manufacturer in the US that is large enough to supply us and many of our competitors now so most of those come from overseas. Many of our products come from Mexico, a lot of our vendors in the aftermarket have opened operations in Mexico and are saving their freight and the leadtimes that they had in China. Though we continue to buy a lot of products from China.

We typically do that through a -- someone that brokers these for us in China. We don't have our own office in China. Sometimes we will direct import them in container loads to our DCS and sometimes we will have a supplier or broker warehouse them for us and distribute from a warehouse here in the US depending on the movement of the item.
And in terms of foreign exchange, are you baking in any benefit on cost of goods sold this year?

We obviously should have some cost decreases as a result and we work on that ongoing. We have a whole team in merchandise that works on that every day. So we would expect to see some incremental benefit as time goes along as we continue to renegotiate deals.

Okay, great. Thanks.

Operator

Christopher Horvers, JPMorgan.

Thanks. Just a question on the balance sheet which I am sure you are prepared for. Was the upgrade something that you were waiting for in terms of it lowers your cost to borrow and therefore using the balance sheet is more likely? Or is it more a discussion around the comp level? Because you are doing a 8 to 7, you didn't need to add debt to grow EPS north of 20% and obviously I think your shareholders appreciate that consistency. So how much of it was a rating and how much of it was simply look we just didn't really need the debt to grow earnings like that?

On the ratings I would tell you that from our opinion, the upgrade has been overdue. Hopefully nobody from Moody's is listening. We felt like the credit quality was already there. It doesn't actually improve our borrowing rate. We are fixed to the better of the two ratings, so we already had a BBB+ on the S&P side. Obviously not being split rated when we issue bonds is a positive so we are very happy about that.

When we look at the debt, we have generated a lot of cash this year, bought back a lot of shares and are happy with where we are. Wouldn't say it was necessarily -- we didn't need to. I would tell you that we manage our debt and we don't like to have cash on our balance sheet, it has got high carrying cost. To issue a bond and have more would make that much worse. But we are working that cash level down and we will add more debt when it makes more sense.

Understood. Greg, you mentioned that the weather dynamic was tougher in the fourth quarter November and it picked up in December which was somewhat ironic considering what others have said and also considering how warm December was at least in the Northeast up here. As you look out to the first half of this year, how would you qualify the weather backdrop? Is this more of a normal winter, not extremely cold, not extremely warm on a national basis and in your key markets because I think some people would make the argument that is not a great weather set up per se.
Greg Henslee - O'Reilly Automotive Inc. - President and CEO

The comment that I made related to November was primarily driven by some of the maintenance things that people do to their cars with the onset of cold weather, antifreeze coolant related. Our anti-freeze coolant did poorly during November -- really it did poorly for the quarter but November was the driver of that poor quarterly performance. We picked up a lot of the business that we would have expected in November in December.

I think that the weather can have an impact in some of the Northeast markets that maybe are subject to big potholes in the road that can do chassis and steering wear and damage on a car. In many markets, it is just not big of a factor. But I think that in many of our markets, it has kind of turned into more of a normal winter not an extreme winter but a normal winter. Although I know that if you look at the average temperatures it would tell you that it has been an abnormally warm winter and obviously that is true.

But I wouldn't look at weather to be a big factor in hurting this year's sales or driving this year's sales. Summer is always an important factor because HVAC sales in the summertime are dependent to a large degree on hot weather and then of course battery failures are driven by hot weather. When you replace a battery in cold weather, it is generally a symptom of the battery just being worn out and done but the damage that caused the battery to fail in cold weather was most likely done during the extreme heat.

So we obviously would have some deferred lack of battery sales if we didn’t have high heat in the summertime but we obviously don’t expect that to be the case. So I would just say it is kind of weather neutral. I wish we were better at weather. As we make our plans internally, we don’t put a lot of consideration into weather and we are expecting to have a solid year.

Christopher Horvers - JPMorgan - Analyst

That is very helpful. Thanks very much.

Operator

Alan Rifkin.

Alan Rifkin - Barclays Capital - Analyst

Thank you very much for taking my question. Greg, with the acquisition of CSK now eight years ago, is it reasonable to assume that your gains in comp and EBIT margin are more a function of corporate-wide outperformance rather than a significant boost from just the stores that were in the former CSK markets? And then I have a follow-up.

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

It is a combination of good performance in the legacy CSK Stores, good performance in the core O'Reilly Stores and good performance in the stores that we have opened after we bought CSK that we include in the way that we look at it internally in our core stores. But generally speaking, as I said earlier if you look at comp percentage, our expansion markets are the highest growth percentages one would expect as those stores come up to what would be considered an average store. And then our lower comp percentages would be our oldest markets where the stores are the most mature but across all divisions in 2015, we generated pretty darn impressive results.

Alan Rifkin - Barclays Capital - Analyst

Okay and a follow-up if I may. Is the growth in commercial more a function of new account additions or is it more so an increase in the number of average ticket with existing accounts?
Lastly if you will, since there is such a great concern on the part of the country heading into a potential recession, could you maybe just remind us how this Company did during the last recession? Thanks a lot.

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

On the commercial business, it is a combination of both. It is a combination of gaining business with existing customers. It is hard to ever have 100% of a customer’s business. You can be first call and you garner a lot of the business, a lot of times they will buy stocking stuff from a wagon peddler and another supplier. There is always business out there to get.

So our do it for me comp growth is a combination of both expanding business with existing customers and just new customers so I wouldn't be able to apply a percentage to that. But it is a combination of both.

If we do go into a recession and history repeats itself, I think there is that kind of initial shock that consumers go through as they realize that some of their retirement investments, things like that aren’t doing as well, unemployment of course goes up which is hurtful. But generally speaking, those things cause people to hang onto their cars longer and make decisions to maintain a car that they have may have been considering trading off. And generally speaking, we perform pretty well during a recession or at least we have in the past and I would expect that to continue to be the case if we were to go back into a recession again.

**Alan Rifkin** - *Barclays Capital* - Analyst

Thank you very much. Best of luck.

**Operator**

Scot Ciccarelli, RBC Capital Markets.

**Scot Ciccarelli** - *RBC Capital Markets* - Analyst

So about 18 months ago or so you guys started to become a little bit more cautious on let’s call it future gross margin expansion. So with the help of hindsight, what were the key drivers to pretty consistently exceeding your gross margin expectations? That is number one.

Number two, when you look at 2015, Tom, can you tell us what the change was just in your merchandise margins rather than the whole?

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

I will answer the first one first. We are not going to break down the portions of our gross margin. On the 18 months ago, what we saw was some improvement as our CSK acquisition deals came due. If we look at the last 18 months, we have had some critical categories where we have either made some changes to go to a house brand or there have been competitive situations out there with some major shifts in the market for suppliers and their capacity that has allowed us to garner better deals.

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

And from a distribution cost standpoint we continue to benefit from just good efficiencies in distribution and of fuel costs are a significant factor in decreasing our distribution costs.
And just given the progress that you have made over the last couple of years which has been obviously quite sizable, how should we think about it kind of longer-term? Is there moderation or just given the market share gains that you have been able to generate and you can kind of sustain the rate of expansion that you have been able to exhibit in the last year or two?

The rate of the expansion that we have experienced over the last couple of years is not sustainable. We would expect ongoing incremental improvements but we wouldn't expect to increase our gross margin at the rate that we have in the past.

Tom, what would you say the rate that we word give if we were to give a projection?

Probably 10 to 20 basis points. But what we would tell you is that our focus is not gross margin percentage. Our focus is our comparable gross margin dollar growth. And over the last three or four, five years our industry has generated those growth through increased percentage due to reduced acquisition costs without the benefit of topline inflation. And what I would tell you is at some point we will have inflation in the market that will help generate topline growth and flow through to our gross margin dollars.

Sounds like they need you on the Fed Board there, Tom. All right, thanks a lot.

Operator

Mike Baker, Deutsche Bank.

Thanks. I wanted to ask one longer-term question which comes up ever so often on this call. But it has to do with the aging of vehicles and I know in the past people have thought of the sweet spot as years 7 to 11 or maybe 6 to 12 and then you have said that has been extended; the sweet spot maybe goes out to year 15 or 16 now as people are keeping their cars on the road longer.

But as I look at from SARS from seven, eight, nine, 10 years ago, the number of cars in that bucket even going out to 2015 looks like it is going to start to decline and in fact declined in 2015. So how do you think of that as impacting your overall industry understanding that you are taking market share but does that become a headwind at some point?

Well, obviously it depends on the SAR in the coming years as well as what has happened in the past. What I would tell is I don’t think we really know what the end of this what we call our sweet spot in these later motor vehicles that have been -- that were built much better from a drive train, body and interior perspectives in some of the older vehicles. Today we monitor the parts that we sell and what they minimal many parts cross years so
it is not always -- you can’t always get the exact date in unless we looked it up in our electronic system and track it. I can tell you that there are a lot of older cars on the road that back a few years ago would not be cars that we would be selling the volume of parts for that we do today.

So I think it is a little bit of an unknown as to how long people will continue to drive some of these vehicles that are in the 13, 14, 15, 16 year age range but you see a lot of them around. And in markets where you don’t have major corrosion issues like up in the Northeast where cars just get a lot of salt and corrode more than they would in some markets, I would expect that these cars will stay on the road longer than what most of us have foreseen. And that we will continue to sell parts for them for years to come. I don’t if you have any additional comments on the vehicle population issue?

Tom McFall - O’Reilly Automotive Inc. - EVP and CFO

What we would tell is a high SAR is good for our industry. The SAR and the scrap rate are two different items and to the extent that the scrap rate continues to stay low as these better engineered and manufactured vehicles stay on the road longer and the SAR goes up, we see more vehicles in the marketplace.

And during the great recession for the first time in a long, long, long time, the vehicle population in the US flattened out and our expectation is that it will continue to get back on a growth track and that is what we saw in 2015 and we will see in 2016. So a high SAR means that people are working, they’ve got money in their pocket, those used cars are going to become new cars for someone else and more cars on the road driving more miles is good for our industry.

Mike Baker - Deutsche Bank - Analyst

Thanks for that color and that detailed answer. If I could slide in two more quick ones, what are you seeing in markets that are impacted by lower oil prices i.e., Texas? And then you talked about more aggressive advertising. Could you flesh that out a little bit, what quarter should we expect that to occur?

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

On the markets that are impacted by oil prices, Oklahoma and Texas will be two that we would call out and there are markets where it definitely has some effect on that heavy duty business or some of the items that might be sold to these oil rigs and the people that work in these oil rigs. We have never been that good at that business. Some of our competitors put some effort into that but we don’t do a lot of that. It has helped a little bit on the employment front because there is the opportunity for the guys that can make pretty good money working on those oil rigs.

But it definitely hurts the economies to some degree. Although Texas is growing so fast for multiple reasons that it continues to be just an absolutely fantastic market for us in a big part of our expansion has been down there and will continue to be down there as we fill out our San Antonio DC.

But I would say that it is certainly not a positive but it is not much of a negative but it will continue to be more of a negative if oil prices continue to stay down because a lot of the companies down there are smaller companies that will have cash pressure put on them if oil prices don’t go up here pretty soon.

On advertising, Tom, do you want to take the advertising question?

Tom McFall - O’Reilly Automotive Inc. - EVP and CFO

For advertising, we would expect to be higher spend in the second and third quarter which are our highest volume quarters.
Mike Baker - Deutsche Bank - Analyst

Thank you. Very helpful. Appreciate the time.

Operator

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

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

Thank you, Adrian. We would like to conclude our call today by thanking the O'Reilly Team for the outstanding 2015 results. We are extremely proud of our record-breaking fourth quarter and our full-year and we remain extremely confident in our ability to continue to aggressively and profitably gain market share and are focused on continuing our momentum throughout 2016.

I would like to thank everyone for joining our call today. We look forward to reporting our first-quarter results in April. Thanks.

Operator

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