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ORLY - Q1 2016 O'Reilly Automotive Inc Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the O'Reilly Automotive Inc. first-quarter earnings conference call. My name is Brandon and I will be your operator for today. 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 it over to Mr. Tom McFall. Sir, you may begin.

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

Thank you, Brandon. Good morning, everyone, and thank you for joining us. During today's conference call, we will discuss our first-quarter 2016 results, and our outlook for the second-quarter and remainder 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 statements due to several important factors described in the Company's latest Annual Report on Form 10-K for the year ended December 31, 2015 and other recent SEC filings. The Company assumes no obligation to update any forward-looking statements made during this call.

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

Greg Henslee - *O'Reilly Automotive - 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, is also present.

It is my pleasure to begin our call today by congratulating Team O'Reilly on another record-breaking quarter and an excellent start to 2016. We are very pleased with our first-quarter comparable store sales increase of 6.1%, which excludes Leap Day, and is on top of an increase of 7.2% in the first quarter of 2015 and 6.3% in the first quarter of 2014.

This repeated market-leading performance is the direct result of our outstanding team of over 73,000 dedicated team members and their unwavering commitment to providing consistently-excellent levels of customer service. Our experienced and hard-working team has now generated a remarkable 10 consecutive quarters of comparable store sales increases in excess of 5%.

These consistently robust results would just not be possible without our team's dedication to living the O'Reilly culture of going above and beyond for each of our valued customers. And I want to thank each of our team members for their continued contributions to our Company's long-term success.

For the first quarter, our team drove a total sales increase, excluding Leap Day, of 8.9%. And our diligent focus on profitable growth and expense control translated this topline performance into a record high first-quarter operating margin of 19.9%, also excluding Leap Day, which positively impacts first-quarter operating margin by approximately 12 basis points as we leverage fixed costs over the extra day of sales.

This operating margin performance was 143 basis point improvement over the first-quarter of 2015, and we are very proud of these record-breaking first-quarter results. During the quarter, we generated earnings-per-share of $2.59. Our EPS guidance of $2.41 to $2.51 for the first-quarter included Leap Day. But on a year-over-year basis, we benefited approximately $0.05 as a result of the extra day.

On a comparable basis, our EPS of $2.54 represents an increase of 23% over the prior-year, which is the 29th consecutive quarter we have grown EPS in excess of 15%. This is a truly remarkable string of outstanding performance, and I couldn't be more pleased with the results of our team's consistent focus on providing outstanding service to our customers.

When we look at the cadence of our sales performance for the first quarter, we saw solid demand in each month of the quarter, with our strongest outperformance coming in the first two months when results came in above our expectations. March results were in line with our expectations despite the slow start to spring we've seen in some markets.

Spring has now arrived in full force over the past couple of weeks. Trends have strengthened. And to this point in the quarter, comparable store sales are in line with our expectations. However, we face tough comparisons on a two-year and three-year stack basis. Considering all the factors driving our comparable store sales performance, we feel it is appropriate to set our second-quarter comparable store sales growth guidance at a range of 3% to 5%, in line with our full-year guidance.

The composition of our comparable store sales growth in the first quarter repeated the same trends we saw throughout 2015. Both our professional and DIY sides of the business were strong contributors to our comparable store sales growth, with professional being slightly higher. We saw solid increases in both comparable transaction count and ticket average, with a larger contribution from our professional ticket count, although our DIY ticket count growth continues to be solid.

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've seen for quite some time now, was largely driven by key hard parts categories such as it brakes, chassis, and driveline.

From a macroeconomic standpoint, we continue to benefit from positive tailwinds from modest improvements in employment and low gas prices, and miles driven are off to a solid start thus far in 2016. We feel the positive trend in miles driven has been an important factor in fueling our robust comparable store sales growth, and will continue to deliver solid demand in our industry for the remainder of 2016, although at a lesser degree on a year-over-year basis compared to the significant tailwinds in 2015.

As we noted in our press release, our gross profit outlook for the second-quarter includes a LIFO headwind of approximately $23 million for anticipated acquisition cost reductions from a specific second-quarter supplier deal, which was not contemplated in our initial 2016 guidance. Tom will discuss this in more detail in a moment, but we view this headwind largely as lumpiness in the timing of our 2016 gross margin, and we still expect to achieve our previously-stated full-year gross margin range of 52.3% to 52.7%, although potentially on the lower end.

We are also reiterating our full-year 2016 operating profit guidance at 19.3% to 19.7% of sales. Earnings-per-share -- before earnings-per-share, we are establishing our second-quarter guidance at $2.54 to $2.64, which includes the LIFO pressure, and at the midpoint, would represent a 13% increase over EPS of $2.29 in the second-quarter of last year. As a reminder, our EPS results in the second-quarter of last year were negatively impacted by a $19 million charge for an adverse verdict in a long-term contract dispute with a former service provider.

On a comparable basis, absent the 2015 charge and the anticipated 2016 LIFO headwind, the midpoint of our earnings-per-share guidance range would be $2.74, a 14% increase over the prior-year, which is consistent with the increase on an unadjusted basis. Our guidance includes incremental interest expense from our $500 million March issuance of senior notes, as well as the impact from all the shares repurchased through this call, but does not include any future share repurchases.

Before I turn the call over to Jeff, I would like to again thank our team for our record-breaking first-quarter 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 a very strong start to 2016. I will now turn the call over to Jeff Shaw.

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

Thanks, Greg, and good morning, everyone. I'd like to begin my remarks by echoing Greg's comments and congratulating Team O'Reilly on another outstanding quarter and a great start to 2016.

Our team continue to exceed the high bar they've set with their past performance by once again delivering industry-leading comparable store sales growth and record profitability. The secret to our team's consistent track record of success really isn't a secret. It's our team's dedication to working harder than our competition and providing excellent service to each of our customers.

For the quarter, we grew total revenues 10.2% and total gross margin dollars by 11.2%. Our incredibly steady run of generating profitable growth is a 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 I'd like to spend a little time talking about our SG&A expense for the first quarter. Our team continues to remain fully committed to building strong relationships with our customers and gaining market share, while at the same time keeping a close eye on expenses. And as a result of their efforts, we levered SG&A by 108 basis points for the first quarter.

This SG&A performance exceeded our expectations and is a direct reflection of the discipline our team demonstrates in making sure that every expense dollar is spent to enhance our service to our customers. Our significant SG&A leverage is the result of our strong comparable sales results, coupled with an increase in average SG&A per store of 2% in the first quarter, which is well within our expectations, especially in light of the higher variable cost associated with strong comps and increased customer counts.

We continue to expect our full-year increase in average SG&A per store to be approximately 2%. However, we will closely monitor our sales volumes and will make appropriate adjustments as needed to prudently manage SG&A expenses, both up and down, to match business trends and the opportunities we see in the marketplace.

We successfully opened 52 net new stores during the first quarter and we continue to be pleased with the performance of our new stores. During the quarter, we opened stores in 22 different states with the highest concentration in some of our newer growth markets in Florida and the Northeast, as well as continued growth in existing markets such as Texas.

As we've discussed in the past, our ability to continue to drive profitable growth for several years in Texas has strained our DC capacity, but we are excited to report that progress on the construction and stocking of our newest DC in the San Antonio market is right on schedule, and we are on target to open the DC in the next month. The San Antonio DC will have the capacity to service approximately 250 stores. And over the course of the next few months, we will immediately transfer a significant number of stores to the new DC, freeing up much-needed capacity in our Dallas and Houston DCs.

Opening the new stores and new distribution centers are long, complex processes that involve every area of our Company. Just as importantly, the most critical component of any new store or DC opening is the identification and training of the teams that will live the O'Reilly culture and provide excellent service to our customers.

Our store and DC leadership teams continue to do a fantastic job instilling our culture and business philosophy in our newest teams, and I want to thank them for their continued dedication to excellent customer service. It's always a good thing to start off a new year with a great first quarter, and we're obviously pleased with the outstanding job by Team O'Reilly so far in 2016.

As I close my comments, I must reiterate that we will never rest on past successes, but will continue to out-hustle and out-service our competitors to earn our customers' business each and every day. I am confident we have the right team in place to continue to provide unwavering customer service and take market share the rest of 2016. And I want to once again thank Team O'Reilly for their continued dedication to our Company's success.

Now I'll turn the call over to Tom.

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

Thanks, Jeff. I'd also like to congratulate all of Team O'Reilly on a great start to 2016. Now we'll take a closer look at our quarterly results and update our guidance for the remainder of 2016.

For the quarter, sales increased $194 million, comprised of $113 million increase in comp store sales, a $52 million increase in non-comp store sales, a $24 million increase from Leap Day, a $6 million increase in non-comp non-store sales, and a $1 million decrease from closed stores. For 2016, we continue to expect our total revenue to be $8.4 billion to $8.6 billion.

For the quarter, gross margin was 52.4% of sales and improved 47 basis points over the prior-year. This was within the range of our expectations, as we benefited from the mix of sales and leverage on distribution costs driven by strong sales, offset by LIFO headwinds of $13 million, which were above our expectations. Excluding LIFO from both years, gross margin increased 66 basis points year-over-year.

As we described in our press release, and Greg mentioned earlier, we are anticipating significant unplanned LIFO headwinds in the second quarter. Specifically, we expect to see a LIFO charge related solely to a supplier renegotiation for a specific major hard part sign of approximately $23 million. This charge is the result of a macro shipped in the supplier landscape for this product line and will impact margin above and beyond the normal pressure we see on a quarter-to-quarter basis from more routine acquisition cost decreases.

As a refresher, we incurred these non-cash LIFO headwinds as a result of our historic success in reducing acquisition costs to the point where we have exhausted our LIFO reserve. And further cost decreases require us to reduce our existing inventory value to the lower cumulative acquisition cost. While this specific new vendor deal will pressure our gross margin in the second quarter, we will realize improved gross margins from the lower acquisition costs on a go-forward basis.

And we are reiterating our gross margin guidance of 52.3% to 52.7% of sales for the full-year, with the expectation we made in the bottom end of that range. This assumes pricing in this industry will continue to remain rational.

Our effective tax rate for the quarter was 37.0% of pretax income. For the full-year, we continue to expect our tax rate to be approximately 36.7%, with the remaining quarters being relatively consistent, with the exception of the third quarter when we adjust our tax reserves for the tolling of open tax periods. These estimates are subject to the resolution of open audits and our success in qualifying for existing job tax credit programs.

Now we'll move on to free cash flow and the components that drove our results. Free cash flow for the quarter was $384 million, which was a $69 million increase from the prior-year, driven primarily by increased income. We are reiterating our full-year guidance of $750 million to $800 million. Inventory per store at the end of the quarter was $584,000, which is a 1.5% increase from the end of 2015.

This growth rate was in line with our expectations for the quarter, and we continue to expect inventory per store to grow approximately 1.5% for the full-year. Our ongoing goal is to ensure we are growing per store inventory at a lower rate than the comparable store sales growth we generate. And we expect to continue our success with effectively deploying inventory in 2016.

Our AP to inventory ratio finished the first quarter at 103%, which exceeded our expectations and represented a new high for this ratio. As we saw through much of 2015, our AP percentage in the first quarter benefited from incrementally improved terms and strong sales. As we progress through 2016, we expect our AP to inventory ratio to moderate somewhat to closer to 100%, as we incrementally improve our vendor terms but face the headwinds of a lower expected increase in sales, based on our current comparable store sales guidance for the remainder of the year.

Capital expenditures for the quarter ended up at $104 million, which was up slightly from 2015 and in line with our expectations. We continue to forecast CapEx at $460 million to $490 million for the full-year of 2016.

Moving on to debt. We finished the first quarter with an adjusted debt to EBITDA ratio of 1.72 times, which is still well below our targeted ratio of 2 to 2.25 times. However, it is up from the 1.52 times at the end of 2015 as a result of our successful issuance of $500 million of senior notes in March.

This was our first new debt issuance since the second quarter of 2013, and we were pleased with the execution of the senior notes offering and our ability to secure attractive long-term interest rates as an investment grade borrower. However, the incremental interest expense from this debt issuance will be a headwind to 2016 earnings-per-share until we effectively deploy this capital.

We continue to believe our stated leverage range is appropriate for our business, and we will move into this range when the timing is appropriate. We also continue to execute our share repurchase program. And year-to-date, we have repurchased 1.5 million shares at an average share price of $256.94 for a total investment of $384 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.

And we will prudently execute our program with an emphasis on maximizing long-term returns for our shareholders. To recap our full-year earnings-per-share guidance, we expect the LIFO headwinds in the second quarter, and the incremental interest expense from our first-quarter debt issuance to be offset by our first-quarter EPS beat and the benefit of the shares repurchased since our fourth-quarter conference call.

As a result, we are reiterating our full-year EPS guidance of $10.10 to $10.50. In line with our normal practice, our guidance includes all of the shares repurchased through this call but does not include any future share repurchases.

Finally, I would once again like to thank the entire O'Reilly team for their continued dedication to the Company's success. Congratulations on an outstanding start to 2016.

This concludes our prepared comments. And, at this time, I'd like to ask Brandon, the operator, to return to the line and we'll be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Michael Lasser, UBS.

Michael Lasser - *UBS - Analyst*

Thanks a lot for taking my question. My first question is on the comp. It was solid, but it was slightly slower than what you've seen in the last few quarters. Do you have a sense if the underlying demand in the market slowed a touch, consistent with what you said about what you saw in March? Or do you think the share gains that you've been experiencing have decelerated? And how does that break down between the DIY and the DIFM segment?

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

Well, I think what I would say, Michael, is that we had a solid trend throughout the quarter. We've been on a solid trend for a long time. On a three-year stack basis, we have a tough three-year stack. And we kind of expected some moderation to the 7%-plus quarterly comp store sales gains that we've been achieving, as we continue to stack up these years and quarters of pretty incredible comp store sales growth.

So we really don't see it as much of a change. I think if you look at a three-year stack basis, it's actually a little bit of a -- of an improvement. But, yes, I wouldn't relate it to anything specific, other than towards the end of the period, when we were comparing against real solid spring weather at the end of the period last year, we had a pretty slow start to spring.

We had markets where we had snow in the upper Midwest. When we didn't have snow last year, we shut business down. We had floods down in Texas, which -- and we had stores closed for several days down in Texas at some point during the floods, which that comes back around as a positive in the long-term, but it can affect short-term results.

Michael Lasser - *UBS - Analyst*

And Greg, it seems like over the last few years, the phenomenal comp results you've been generating have been driven in part by an expansion of a number of people that you have in your stores, the advertising, the number of products you carry, and your supply chain. If you see a potential constraint that might lock your ability to generate these types of comps moving forward, where would it be?

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

I don't see a constraint. I think that we are in a fantastic position from a people standpoint. I think culturally, we are an incredibly strong company. I think supply chain -- there's no one that really compares to the supply chain and the availability that we have. I think from a merchandise and product line-up standpoint, we are in a great position. I think from a pricing perspective, we are in a great position. I don't see any reason that we won't continue to generate industry-leading comparable store sales.

Michael Lasser - *UBS - Analyst*

And my last question is on the LIFO charge that you are going to see in the second quarter, and putting your gross margin for the full-year at the low end of the range. So now should we interpret that -- the gross margin is going to be a little bit lower than what you thought for the full-year, but yet the benefit from that will carry into next year? And so perhaps the gross margin next year will be a little bit better than what was previously thought?

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

Yes. The benefit from the cost reductions that we have will be ongoing from this point forward, but we'll have the second-quarter headwind of the write-down in the inventory that we are taking as a result of the cost reductions, which will affect our full-year gross margin. But we still end up in the range that we had given at the first of the year.

Michael Lasser - *UBS - Analyst*

Okay. Thank you so much and good luck with the quarter.

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

Okay. Thank you, Michael.

Operator

Bret Jordan, Jefferies.

Bret Jordan - *Jefferies LLC - Analyst*

I got on just a hair late. Did you talk about regional performance? I heard you talking about categories like brakes and chassis that were strong, but did you talk about the map at all?

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

We didn't talk about the map at all. I'll make a few comments on that. We had solid contribution really from all areas of the country, with the best outperformance being in the Southeast and mid-Atlantic regions. But really all parts of the country had solid comparable store sales.

Bret Jordan - *Jefferies LLC - Analyst*

Okay, great. And then as you've expanded into the East in some of the non-legacy markets, do you see the customer product mix change at all? Is there more demand for branded parts where people are less familiar with O'Reilly as a retailer? Or are you pretty consistent direct source versus branded?

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

We offer both in many product categories. Generally speaking, our -- we call them private labels, but we really market them as branded product because they are high-quality products that we sell in boxes that are the brains that we represent, although most, we consider them private label.

It's just from a pure acquisition and supply standpoint. But generally speaking, the performance of our proprietary brands or private labels has been better than with our branded products, even in those markets that you spoke of.

Bret Jordan - *Jefferies LLC - Analyst*

Okay, great. Thank you. And I guess one last just housekeeping. Is there a reason that you couldn't take AP to inventory well over the 103%? Is -- I mean, obviously, you cracked that 100% barrier; now you're talking about it being around 100% for the year. But the leader is at 112%. Is there a reason why you couldn't be there?

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

Bret, we are never going to stop trying. But there are some challenges with that when you compare us to the other company you are talking about, relative to some of the brands that we carry, which are just more traditional represented brands. And they supply some customers who, if they gave those terms to us, where they would have to give them to those customers, and they're just reluctant to do that. And frankly, their brands are strong enough that they are able to encourage us to buy their products without the terms. And we are happy to do so.

Bret Jordan - *Jefferies LLC - Analyst*

Okay, great. Thank you.

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

Great. Thank you.

Operator

Simeon Gutman, Morgan Stanley.

Simeon Gutman - *Morgan Stanley - Analyst*

The first question, to build on something Michael asked regarding market share gains, Greg, the two categories where we suspect that are O'Reilly was picking up some share, were filters and then in the belt, the belts categories. Was there anything -- I don't know if you will agree with those categories, but if you look at those in particular, is there anything regarding the sales trends there that suggests there is a topping off or just a slowdown in momentum?

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

No, there's not. At least to this point, there's not. I mean at some point, as we have, we start further anniversarying some of the changes that took place in the competitive landscape. And the solid gains we've had in those categories as a result of those changes, I would expect the comp percentage and dollars, on a comparative basis, to decrease some. But to this point, we've not seen that.

Simeon Gutman - *Morgan Stanley - Analyst*

And the timing for the anniversarying, was it -- is it in the first-half of this year? Or does it happen more in the latter half?

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

Yes, I believe it would be about this time last year. So I think it's -- I think we are coming up on that period now.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay. And then second question, regarding buybacks. I think, this quarter, you spent more in Q1 than any previous -- I think since you initiated the buyback program. And I'm sure you will respond talking about it opportunistically. But any rhyme or reason as to the timing or the magnitude this time around?

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

Yes, Tom, do you want to take that?

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

We don't have a very long open window during this period each year because of the time to file the K. So we buy off the grid and the market cooperated better with our grid this year than it did last year.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay, that's helpful. Thank you.

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

Thanks, Simeon.

Operator

Seth Basham, Wedbush.

Seth Basham - *Wedbush Securities - Analyst*

My first question is around the commercial business. Could you give some more color on what areas of that business you are seeing the most strength from in terms of account size, more strength from the national or regional accounts or the up-and-down-the-street accounts?

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

Jeff, do you want to take that?

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

Yes, I mean there again, I think that we've probably been more aggressive on the national accounts than we have been in the past. So we are seeing solid growth there. But I mean we focus on every account in the market, and get out there and work every account. And we are seeing growth on really both sides of the business.

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

The majority of our business obviously is not national account business. So we've -- we're very successful with the up-and-down-the-street shops, which is the majority of our business and the majority of our comp store sales growth.

Seth Basham - *Wedbush Securities - Analyst*

Fair enough. And then, Tom, on the LIFO issue, if you could give some color on when you expect to fully recapture that $23 million?

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

Well, it will depend on our sales sellthrough. Part of the reduction will be captured this year. It's probably a one year recapture on that.

Seth Basham - *Wedbush Securities - Analyst*

Very good, thank you.

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

Thank you.

Operator

Greg Melich, Evercore ISI.

Mike Montani - *Evercore ISI - Analyst*

This is Mike Montani on for Greg. Just wanted to ask, if I could, about inflation. You know, Greg, you called out there is none of it really happening today, but the question I had was around the potential for increased labor cost, depending on what happens with Department of Labor rulings on overtime, and also potential interest rate increases.

So, Tom, I don't know if you can talk about your ability to pass those things through if it happens, and how you might manage labor between store managers and assistant managers to preserve margin?

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

Well, obviously, we are monitoring closely expected changes that are going to come out. The key for us is an input cost, so our competitors are going to have the same costs that we are, and we would anticipate passing those along.

The key for us is to make sure that our compensation plans continue to have our store managers run the business like they own it. So that's a very sensitive area for us.

On interest rates, to the extent that interest rates go up for our suppliers, interest rates are an input costs into their product and we would expect that increased -- potential increased acquisition cost to hit across the industry and be passed along. From an individual, our Company interest rate perspective, all our debt is locked.

Mike Montani - *Evercore ISI - Analyst*

Have you all seen anything? Or are there any grumblings as of yet that there could be some inflation in the pipeline? Or is that premature?

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

We have not seen that denoted by our LIFO charges.

Mike Montani - *Evercore ISI - Analyst*

And the last one I had was just on Easter shift. Could that have been part of the reason for slowing in March? And then also, commensurately part of the reason for April to be better? Could you just give some extra color around that, please, Greg?

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

Of course, there is a calendar shift, and it would have put some pressure in March and then we have a little bit of benefit in April. I think we'd estimate it to be about, what, 30 basis points maybe or something like that? Yes.

Mike Montani - *Evercore ISI - Analyst*

Okay, great. Thank you.

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

Thank you.

Operator

Daniel Hofkin, William Blair.

Daniel Hofkin - *William Blair & Company - Analyst*

Just wondering if you could -- as you are looking forward, and it sounded like you expect some of the tailwinds to continue, although perhaps at a lesser rate -- just what specifically would you expect to diminish, if you will, in terms of year-over-year benefit?

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

Year-over-year benefit just in comp store sales growth, Dan?

Daniel Hofkin - *William Blair & Company - Analyst*

Yes.

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

Well, we -- like I said earlier, we just have tougher comparisons. We are not really expecting any diminishing trend. We think miles driven being up like it is, is a contributor. The average age of vehicles is a contributor. Employment being where it is, is a contributor.

I know there's some ways around whether or not the soft winter will hurt demand. And certainly, in some markets, that could have some effect on under-car parts that can be damaged on rough roads and potholes and stuff like that. But generally speaking, we are not anticipating a diminishing trend.

Daniel Hofkin - *William Blair & Company - Analyst*

Okay. And then just one additional follow-up on the whole LIFO thing. So just to be clear, that's $23 million on top of whatever underlying LIFO charge you might have already expected to have in 2Q, is that correct?

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

That is correct.

Daniel Hofkin - *William Blair & Company - Analyst*

Can you give us a rough idea of what you're expecting then for the overall gross margin for the second quarter? I mean that's about a 100 basis point incremental drag, if I understand.

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

Well, we have said that gross margin is going to be relatively consistent quarter-to-quarter. We don't give quarterly gross margin guidance. So I think it would be safe to pick which number you think it is in the range and apply that specific charge to come up with a gross margin for the quarter.

Daniel Hofkin - *William Blair & Company - Analyst*

Okay. Thanks very much.

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

Thanks, Dan.

Operator

Brian Nagel, Oppenheimer.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Thanks for taking my questions. The first question with respect -- I guess bigger picture in nature -- but with respect to gas prices, you've called out -- and I think you mentioned today in your prepared comments again that lower gas price has definitely been a benefit to your business. And I agree.

As you look at gas prices, and potentially having bounced off the bottom here recently, do you think this move higher could have any impact negative on your business? Or is there a level you are looking at where it maybe becomes more -- if gas prices reach a certain point, it becomes more of a negative, or at least less of a tailwind going forward?

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

I think when gas prices get up in the mid-3's like they were at one point, I think it becomes a factor. It starts affecting miles driven, which is really the primary driver of demand in our business. So, to the extent that it hurts people's discretionary money and the money they have to spend on things that can be potentially deferred has an effect, and then of course miles driven.

I don't think it was the increases that we've seen. I think that's pretty minor to this point and it's not a factor. But if gas prices were to spike back into the 3's or mid-3's or something like that per gallon, that becomes a factor.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay. It's real helpful. And the second question -- short-term in nature -- but Leap Day. So you called that out, it was a benefit -- I guess so to say, a benefit to the quarter. Just to be clear, Leap Day doesn't show up in your comps then, correctly -- correct?

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

Yes, the 6.1 comp is excluding the additional day. If we include the day, our comp was 7.4.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay. So in view of this -- I know it's kind of a silly question, but okay, so you didn't include it here. Does that potentially take away from comp store sales, either in Q1 or Q2? Because I would assume all the sales are not incremental.

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

Well, I mean, it was just another day. It was a Monday, and we included it in our Q1 report for everything, other than we called out our comps separately excluding today, because it would be comparing an extra day to a day short to prior-year. So, it's included in Q1. It was a Monday, so that's a good day. But it really would have no effect on Q2.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay, thanks.

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

Okay. Thank you.

Operator

Mike Baker, Deutsche Bank.

Mike Baker - *Deutsche Bank - Analyst*

So a couple of questions. Just to be clear, you said that April -- you said that trends had improved since March, but you had said that March was in line and now you are saying April was in line. So maybe I'm trying to cut it too finely, but I was just trying to square those two comments. If trends had improved, I would assume that April was better than in-line, which is what March was?

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

Yes. Well, what I would say is late March and early April, we saw a little bit of a decline in demand with some pretty significant weather events that happened in different parts of the country, really more than one. With the start of spring, and kind of the spring warm weather hitting in most markets, we've seen improving trends and strengthening of our comp store sales.

And to this point in the quarter, we are in line with our expectations. And we would expect that trend that we are on to continue.

Mike Baker - *Deutsche Bank - Analyst*

I understand. So, early April was weak, but since then, it's been better. A couple more little questions. One, you said that the Easter shift helped or hurt by 30 basis points. That hurt the month of March by 30 basis points? Or the total quarter by 30 basis points?

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

The total quarter.

Mike Baker - *Deutsche Bank - Analyst*

Okay, excellent. One more for you, if I could. Just on the guidance. So, you kept the guidance the same. You beat the midpoint of the first quarter by $0.13, but you are taking this LIFO charge, which pretty much offsets that. So, effectively then, if you didn't have the LIFO charge, I assume the guidance would be going up.

But I guess here's the question. You also have a lower share count than you had originally contemplated because you bought back stock in the first quarter. So I would think that the guidance would go up anyway, even with those two offsetting factors, just because of the lower share count, and then maybe offsetting the higher interest expense expected? Just wondering about that. Thanks.

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

That's correct. The higher interest is a known factor. So we have included it within our guidance. But as is our practice, share repurchases after today are not included in our guidance.

Mike Baker - *Deutsche Bank - Analyst*

Okay. So the guidance takes the hit but doesn't give you the benefit. Understood. Thanks.

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

Thanks.

Operator

Matthew Fassler, Goldman Sachs.

Matthew Fassler - *Goldman Sachs - Analyst*

My first question is for Jeff. You spoke a lot about expenses, and you already got a question on overtime. Just generally speaking, as you think about wage pressures in the marketplace, to the extent that you are seeing more competition for your associates, I know that you have great retention -- but anything in the environment that suggests incipient pressure on wages?

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

No. Nothing really any different than we've seen in the past. I mean, there's always a scramble for great people in the market. But nothing -- really no changes that we've seen.

Matthew Fassler - *Goldman Sachs - Analyst*

Great. I have two quick financial cleanup questions. I know you've gotten lots of questions on LIFO, but as we think about next year -- and I know you're not guiding to next year at all -- should we think about, specifically for the second quarter, more or less the full recapture of that $23 million of LIFO, i.e., a particularly easy gross margin compare that should lead to an outsized increase in gross margin in Q2, based on cycling the LIFO charge alone?

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

Hard to know what's going to happen a year from now, but you would expect that we would have the absence of that LIFO -- big LIFO charge in the second quarter of next year and see a big year-over-year gain.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. And then, finally, Greg, you spoke about January/February in contrast to March, and I know you just gave us a little more color on what happened within March and early April, but can you dimensionalize the magnitude of the difference in the rate of sales growth between the first two months of the quarter and the last month of the quarter?

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

It was not that significant. February was the strongest month, but the differences were not that significant. But it was a difference that was worth mentioning, because I know you all like to know the cadence of how the quarter progressed. And we would have viewed the end of the period as being the weaker portion directly related to some of the weather things that we were talking about in the spring, that have now strengthened as spring has gotten here.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. Thank you so much, guys.

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

Thank you.

Operator

Tony Cristello, BB&T Capital Markets.

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

Thanks for taking my question.

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

Sure. Tony.

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

I wanted to talk about Texas. And it's a market where you've got a new distribution center opening up, and I believe you've got about 1.3 million or so square feet existing. It's a market that's got about 14% of your store mix.

And so what I'm wondering is what benefits will we see as a result of adding -- well, I guess close to 500,000 or so square feet to this existing market, whether it's distribution benefits or fill rate benefits or cost efficiencies? Because it is such a meaningful part of your store mix.

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

Yes. Well, there are several benefits. One would be that we are -- we have our Houston distribution center and our Dallas-Fort Worth distribution center both running overcapacity, which causes them to not be as efficient from a cost of operations as they could be. and then from a service-level standpoint, we don't feel like they do quite as well as they could if they were operating at a more optimal store count. So there will be some benefit there.

And then in addition to that, as we offload some of the stores that are supplied by those DCs, we can take advantage of expansion opportunities that we see for new stores in both those markets. Because those are both very robust markets for us where we have back-fill opportunities, and have the need and the opportunity to add some stores in those markets that we really don't have the distribution capacity to add today but will have the future.

And then, additionally, with the opening of San Antonio, both San Antonio and Austin are incredible growth markets. And today they are serviced by hub stores, which is just not optimal if you want to be the dominant auto parts supplier in those markets, which we do.

And by putting that distribution center north of San Antonio, south of Austin, we can touch stores in both markets on a same-day basis, and give us an opportunity to increase penetration with existing customers and develop relationships with new customers. And then as we continue to expand, expand more easily from just a store count perspective, because we'll have the capacity to do so out of San Antonio.

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

Okay, that's very helpful. And then so -- I mean Texas has got a lot of land and opportunity for you to put distribution centers. As you start to move into the Northeast and even into some of the East Coast markets, are you more constrained with your approach of how you have to build your distribution network? Or do you still think you can optimize it similar to what you are doing here in Texas?

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

No, our plan is to execute the same business plan and strategy that we've executed across the country, as we expand into some of these Northeast markets that are more densely populated and have more cars than people. Certainly, having parts close to the customer is a critical component of success in our business, and we'll continue to execute the strategy that allows us to have distribution capacity that allows us that availability advantage that's so important, we feel like, to our success.

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

Okay, that's great. Thanks for your time.

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

Okay. Thanks, Tony.

Operator

Kate McShane, Citi Research.

Kate McShane - *Citi Research - Analyst*

This is just building on the last question and some of your prepared comments, but one of the competitive advantages that you listed as to why things continue to go so well for the business, is the supply chain. And while I know the DC network is very important, I wondered what longer-term investments -- sort of just continuing investments you can -- you make in the supply chain to continue to be at your best and have that competitive advantage?

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

Yes. I think we continue to invest in supply chain from an efficiency standpoint. We continue to look for appropriate means to make more parts available on a same-day basis to our stores. You know, as cars continue to use more different parts on a year-over-year basis, this proliferation of the number of part numbers that it takes to cover the vehicle population in the US becomes a more important factor in being that first-call supplier.

So we have some things that we can do to even further leverage the existing distribution network we have. And then in the future, we'll be working on ways to improve availability. Important to us is maintaining a competitive gap in availability. And we feel like we have that today. And we feel like we have the ability to continue to maintain that gap, as our competitors further realize the importance of availability and work to expand their availability on a same-day basis. And we will continue to work on ways to do that.

Kate McShane - *Citi Research - Analyst*

Thank you.

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

Okay. Thank you, Kate.

Operator

Carolina Jolly, Gabelli.

Carolina Jolly - *Gabelli & Co. - Analyst*

Thanks for taking my call. Just one quick follow-up on the Easter shift. You said 30 basis points to the headwind. Just wanted to see if you had that either in EPS numbers or if you had a Leap Year in comps? Or that you --?

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

Okay, the Leap Year in comps, if we included it, would be -- we would have had a 7.4% comp in the quarter if we had included Leap Day. I'm unsure of the 30 basis point Easter effect in sales on EPS.

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

We are open on Easter. Easter business is just slower.

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

Yes, I assumed everybody knew that we didn't close the stores on Easter. We are just not as busy on Easter as we are any other Sunday.

Carolina Jolly - *Gabelli & Co. - Analyst*

Great. Thanks. And then to follow up on your comment from the last question, you kind of mentioned that some people are improving their efficiency. Can you talk about ways you are maintaining the share gains that you kept in the past, other than availability? And then also what would stop maybe some of your competitors from trying to compete on price?

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

Nothing. I think that our competitors are very price competitive today. I think we have always been in a very price competitive business. So that's always something that we monitor and shop and watch for. But you know pricing has remained rational for some time and we would expect it to in the future.

Our competitors -- many of them have really good supply chains. I think ours is, generally speaking, more robust. And I think that we maintain a availability gap over most of our competitors, but I think some of our competitors are improving them. And I think they have the ability to improve them. It simply takes time and execution.

Distribution centers are long-term commitments, so some of the strategies that some of our competitors have in place now are hard things to roll up and change quickly. But I think, over time, if our competitors have the will and the ability to execute a different supply chain strategy, they will do so. At the same time, we'll be working to maintain a supply chain and availability benefit and positive GAAP for us, which we been successful at doing in the past.

Carolina Jolly - *Gabelli & Co. - Analyst*

Great, thank you.

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

Okay. Thank you.

Operator

Chris Bottiglieri, Wolfe Research.

Chris Bottiglieri - *Wolfe Research - Analyst*

Thank you for taking the call. A couple questions. Sorry to lead with LIFO, but with the $13 million, was that related to the $23 million? Or is it a whole separate issue?

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

Different lines and categories.

Chris Bottiglieri - *Wolfe Research - Analyst*

Okay, different lines and categories. But same supplier or --?

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

Different suppliers.

Chris Bottiglieri - *Wolfe Research - Analyst*

Okay. And then for the back-half of the year, do you anticipate any other material LIFO charges? Or it could be just kind of more like Q4, Q3 pace that you had last year?

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

They have been significantly higher than we had planned. We're not planning those types of numbers in the back-half.

Chris Bottiglieri - *Wolfe Research - Analyst*

Okay. All right and then a couple of bigger quick -- bigger picture questions. I saw you announced -- or not that you announced; I think it was announced that you've partnered with an industry consultant on creating a new backend for your website. Wonder if you could talk about that?

And then bigger picture, can you talk more about the O'Reilly First Call online program? What percentage of your commercial sales are done through eCatalog versus store calls? And kind of how do you see that trending in the future? And then the implications you think that has on allocating labor to new business versus serving existing?

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

Okay. Well, our relationship with Broadleaf is simply an effort to refresh and upgrade our web presence, and we are in the process of doing so. They've got a great platform, and we are enthused about the opportunity to work with such a progressive company. And we feel like we have some opportunity to improve our Internet presence, and are in the process of doing so.

And I'm sorry, what was your second question?

Chris Bottiglieri - *Wolfe Research - Analyst*

The second question was generally speaking. Could you talk about the First Call online?

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

Yes.

Chris Bottiglieri - *Wolfe Research - Analyst*

Like what percent of your customers are using eCatalog to order versus calling out Parts Pro, kind of how you see that trending long-term?

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

Yes. It's grown a lot over the last few years. And we have a very strong Web presence when it comes to B2B, and we have had for a number of years. I would suspect that we are one of the higher suppliers from a percentage standpoint, when it comes to the percentage of our sales on the professional side that are done electronically.

I actually don't have the percentage in front of me. It's grown significantly and it will continue to grow. Still, the vast majority of our business is done via phone call. It will be -- yes, it's still phone call. So we have a lot of opportunity, over time, to convert that business to electronic, which we think is pretty sticky. The customers, once they start using your systems, it can stick with you pretty well.

And then secondly, it creates some efficiency for us at the store by not taking a phone call, and simply receiving a pick ticket and shipping a part. But the trade-off is, you don't maybe develop as close of a personal relationship with a customer as you would on a phone call. So there's some trade-offs. But phone call is still the majority of our professional business.

Chris Bottiglieri - *Wolfe Research - Analyst*

Okay. That makes a lot of sense. Thank you for your time.

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

Okay. Thank you.

Operator

We've reached our allotted time for questions. I will now turn the call back over to Mr. Greg Henslee for closing remarks.

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

Thanks, Brandon. We'd like to conclude our call today by thanking the entire O'Reilly team for our outstanding first-quarter results. We are extremely proud of our record-breaking first quarter, and 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'd like to thank everyone for joining our call today. And we look forward to reporting our 2016 second-quarter results in July. Thanks.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for joining. You may now disconnect.