OVERVIEW:

Co. reported 4Q16 EPS of $2.59. Expects 2017 total revenue to be $9.1-9.3b and EPS to be $12.05-12.15. Expects 1Q17 EPS to be $2.78-2.88.
CORPORATE PARTICIPANTS

Tom McFall  O'Reilly Automotive Inc. - EVP & CFO
Greg Henslee  O'Reilly Automotive Inc. - President & CEO
Jeff Shaw  O'Reilly Automotive Inc. - Co-President

CONFERENCE CALL PARTICIPANTS

Matt Fassler  Goldman Sachs - Analyst
Michael Lasser  UBS - Analyst
Carolina Jolly  Gabelli & Co. - Analyst
Mike Baker  Deutsche Bank - Analyst
Dan Wewer  Raymond James - Analyst
Alan Rifkin  BTIG - Analyst
Seth Basham  Wedbush Securities - Analyst
Simeon Gutman  Morgan Stanley - Analyst
Brett Jordan  Jefferies & Co. - Analyst

PRESENTATION

Operator
Welcome to the O'Reilly Automotive, Incorporated fourth-quarter and full-year 2016 earnings call. My name is Richard and I will be your operator for today's call. (Operator Instructions). Please note that this conference is being recorded. I would now like to turn the call over to Mr. Tom McFall. Mr. McFall, you may begin.

Tom McFall  O'Reilly Automotive Inc. - EVP & CFO
Thank you, Richard. Good morning, everyone and thank you for joining us. During today's conference call, we will discuss our fourth-quarter 2016 results and our outlook for the first quarter and full year of 2017. After our prepared comments, we will host a question-and-answer period.

Before we begin this morning, I'd like to remind everyone that our comments today contain certain 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 Inc. - President & CEO
Thanks, Tom and good morning, everyone and welcome to the O'Reilly Auto Parts fourth-quarter conference call. Before we begin our discussion of our fourth-quarter results and our plans for 2017, I'd like to take a few minutes to discuss the announcement we made in our press release yesterday of the promotion of Greg Johnson and Jeff Shaw to Co-Presidents of O'Reilly.
As we’ve discussed many times in the past, our Company’s promote from within philosophy and our deliberate commitment to succession planning are highly critical components of our strategy to build the very best team in our industry. In conjunction with that strategy, we are extremely pleased to have Greg and Jeff assume the elevated leadership roles of Co-Presidents of the Company. Greg and Jeff have both proven time and again their exceptional leadership qualities and their contributions over the last three decades are a reason why O’Reilly consistently provides excellent service to our customers and generates the best results in our industry.

Greg and Jeff truly are long-term success stories. Greg began his career with Mid-State Automotive Distributors as a part-time distribution center team member 34 years ago and officially joined Team O’Reilly with our acquisition of Mid-State in 2001. Over the years, Greg has held key positions in information technology and throughout our distribution and operations group where his leadership has been instrumental in the development of our industry-leading network of 27 distribution centers before taking on his current broader role as Executive Vice President of Supply Chain. As Co-President, Greg is now responsible for the Company’s merchandising, inventory management, advertising, as well as the added responsibilities for information technology, legal, loss prevention, risk management, human resources and finance.

Jeff’s career with O’Reilly began 27 years ago when he joined the Company as a parts specialist at one of our stores in our hometown in Springfield, Missouri. During his tenure with the Company, Jeff has served in every leadership role in our store operations group from store manager through his current role as Executive Vice President of Store Operations and sales and he has been instrumental in several acquisitions during his tenure beginning with the key role he played in our first major acquisition of Hilo Auto Supply in Texas in 1998. Now, as Co-President, Jeff is responsible for the Company’s store and distribution operations teams, as well as expansion, acquisitions and real estate.

Again, I could not be more proud of the many years of service Greg and Jeff have provided our Company and I am excited about the leadership they will provide to Team O’Reilly in their new roles as Co-Presidents. Greg and Jeff are on the call with me this morning, along with Tom McFall, our Chief Financial Officer and David O’Reilly, our Executive Chairman is also on the call.

I am once again pleased to begin our call today by congratulating Team O’Reilly on another strong year in 2016. We finished the year off with a comparable store sales increase of 4.8% in the fourth quarter, which matched our increase for the full year of 2016. The solid 4.8% comp store sales growth for 2016 was at the high end of our guidance of 3% to 5% and came on top of 7.5% and 6% in 2015 and 2014 respectively. Our ability to continue to grow our business and capture market share year in and year out is a testament to our team’s commitment to providing excellent customer service and I want to thank each of our team members for their dedication to our Company’s long-term success.

For the fourth quarter, we grew total sales by 7.7% and for the full year, we generated 7.9% total sales growth. Our ongoing focus on growing sales profitably and controlling expenses translated our solid top-line performance into a record fourth-quarter operating profit of 19.4%. For the full year, we generated a record operating profit of 19.8%, which was a 77 basis point improvement over 2015.

During the quarter, we generated earnings per share of $2.59, which represents an increase of 18% over the prior year. This quarter represents our 32nd consecutive quarter of EPS growth of 15% or greater, excluding the atypical tax benefit in the third quarter of 2015. For the year, we generated EPS of $10.73, which was an increase of 17% over the prior year. This year represents our eighth straight year we have generated annual EPS growth of 17% or greater and this remarkable track record of strong, consistent earnings growth is a reflection of the effectiveness of Team O’Reilly’s customer service-oriented culture, our dual market strategy and our focus on profitable, sustainable growth.

When we look at our sales performance for the quarter, we saw solid demand to start the quarter in October. November was a little slower on the DIY side of the business as we saw headwinds to our business in the time period around the Presidential election and due to the lack of cold weather across many of our winter-sensitive markets. However, with the onset of colder temperatures in December, we drove a stronger sales trend to finish the year.

As we saw in the third quarter, the composition of our comparable store sales growth in the fourth quarter was very balanced with our professional and DIY sides of our business both contributing equally to our comparable store sales growth. For the full year, we saw steady increases in both comparable ticket average and transaction count with a slightly 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 reflation remains muted.
On a category basis, we continue to see solid performance in key hard part categories such as brakes and chassis. With the onset of cold winter weather in December, our weather-related categories, such as batteries and HVAC performed very well. The lingering effects of last year’s mild winter, which caused a gap through most of 2016 between the stores in weather-affected regions and the rest of the Company, have now ceased to exist as winter weather returned in December.

For 2017, we are establishing comparable store sales guidance of 3% to 5%. Over the past three years, the improving health of the economy and increase in employment and the associated increase in commuter miles has been a key driver of the growth in miles driven, which are up 3% year-to-date through November 2016 after seeing an increase of 3% in 2015 and 1.7% in 2014.

In developing our guidance for 2017, we expect for these gains to be sustainable and to see additional positive tailwinds from a modest increase in miles driven as employment remains stable and the macroeconomic environment gradually improves. We expect to see continued growth in miles driven specifically in the population of out-of-warranty vehicles as better engineered and manufactured vehicles are capable of being reliably driven at higher mileages if reasonably maintained, which is being proven out in the continued stable low scrappage rates.

Our guidance expectations include an assumption that our customers will see some pressure from increases in gas prices. However, even with an anticipated increase, gas prices are still low in relative terms and we believe consumers will be able to readily adjust.

Finally, our comparable store sales expectations assume inflation will remain muted as we have seen for the past several years. To the extent that we begin to see inflation in our industry, our sales would benefit from rising selling prices. Against this stable industry backdrop, we are extremely confident in our team’s commitment to providing the highest levels of service in our industry and in our ability to continue to gain market share.

Our first quarter represents our most difficult comparison for the year on a two and three-year stacked basis as we compare against the 6.1% and 7.2% comparable store sales increases we generated in the first quarter of 2016 and 2015 respectively. Our first quarter is also typically the most volatile from a weather standpoint as January and February, our lowest volume months, can be impacted by the severity of winter weather.

December’s severe winter weather drove strong demand for our products, but as we started of 2017, the milder January temperatures resulted in softer demand. However, we still have at least a month of winter left and the timing of the arrival of spring has a big impact on first-quarter results. As a result of these factors, we feel it is prudent to establish our comparable store sales guidance range at 2% to 4% for the first quarter.

We are establishing our full-year 2017 operating profit guidance at a range of 20.1% to 20.5% of sales. The increase over the prior year is driven by gross margin improvements, which Tom will discuss more in detail in a moment, offset by some SG&A pressure, which Jeff will cover.

For earnings per share, we are establishing our first-quarter guidance at $2.78 to $2.88 and for the full year, our guidance is $12.05 to $12.15. 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 another outstanding year in 2016. 2016 marks O'Reilly's 24th year as a public company and we have grown comparable store sales and set record revenue and operating income in each of those 24 years because of your consistent dedication to providing industry-leading service to all our customers every day and I am extremely proud of the job all of you do and I'm confident 2017 will be another record-setting year for Team O'Reilly. I will now turn the call over to Jeff Shaw. Jeff.

Jeff Shaw - O'Reilly Automotive Inc. - Co-President

Thanks, Greg and good morning, everyone. I'd like to begin my remarks by also congratulating Team O'Reilly on another strong year in 2016. Once again, our team’s focus on providing top-notch customer service allowed us to generate comparable store sales and set record revenue and operating income in each of those 24 years because of your consistent dedication to providing industry-leading service to all our customers every day and I am extremely proud of the job all of you do and I'm confident 2017 will be another record-setting year for Team O'Reilly. I will now turn the call over to Jeff Shaw. Jeff.
Now we will spend a little time talking about our SG&A expense in 2016 and our outlook for 2017. For the fourth quarter, we levered SG&A by 47 basis points, driven by our strong sales results and expense control for the quarter. For the full year, we levered SG&A by 31 basis points, excluding a year-over-year benefit of 24 basis points as we calendared an adverse judgment in 2015 with the 2016 improvement also driven by comparable store sales results near the top end of our guidance range. Our increase in average SG&A per store for 2016 was 2.1%, which excludes the adverse judgment headwind in 2015.

As we discussed last quarter, we manage our store-level expense to ensure we provide excellent customer service that develops and maintains long-term relationships. Given additional headwinds we faced this year from healthcare and credit card costs, we are pleased with the improved operating margin our team delivered in 2016.

Looking forward to 2017, we expect per store SG&A to grow at 1.5% to 2% for the year as we expect to see continued pressure from increased wage rates, higher expected medical costs, additional investments in our internal information system capabilities and costs to convert the acquired bond stores. As we saw in 2016, 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 69 net new stores bringing us to our goal of 210 new stores for the year. During 2016, we opened new stores in 39 different states and we continue to be very pleased with the performance of our new stores in both expansion and backfill markets. As we discussed on our last call, our plan is to open 190 net new stores in 2017, which is below our typical new store target as we plan to devote significant resources to converting the Bond stores we acquired in December.

We will again spread our new store openings across our footprint with planned new store openings in 37 states. Our growth will be concentrated in our newer expansion markets in the Northeast, Florida, and the Mid-Atlantic supported by our recent DC additions in Devens, Massachusetts and Lakeland, Florida and our upcoming expansion in 2017 in Greensboro, North Carolina.

In 2017, we will also see continued backfill in existing markets in Texas and the Great Lakes, supported by our newer DCs in San Antonio and Chicago, as well as several other markets across the country. Our organic growth plans in 2017 reflect the continuation of a consistent strategy we’ve deployed throughout our history. The key to opening great new stores and taking share in new markets is to develop strong store teams, which live the O’Reilly culture and provide excellent customer service and to support those teams with the critical tools they need to take care of their customers.

We have the distribution capacity throughout our chain, which allows us to spread out our store growth across the country so we can take the time we need to put in the best team in place when we open a new store. The significant investments we’ve made in our expansive supply chain infrastructure also ensure our stores have the parts they need to compete in each of our markets.

From day one, every new store, even a store in a brand-new market area for O’Reilly, receives access to the broadest parts availability in the industry, including five night a week delivery from a distribution center usually supplemented with multiple daily deliveries from a DC or a hub store. It isn’t easy or inexpensive to provide this level of service to our stores and it certainly isn’t easy to replicate, but providing the best parts availability to our customers is built into our culture, as well as our business model.

Our ability to control expenses and efficiently execute our intensive supply chain strategy while still expanding our distribution network and adding new stores is a significant competitive advantage. As I have said in the past, there’s a tremendous amount of work that goes into opening new stores and DCs and I’m proud of the great work our entire team does to support our growth.

Finally, I’d like to finish up today by providing an update on our previously announced acquisition of Bond Auto Parts. We closed on the acquisition in early December and we are very excited about the great professional parts people who have joined our team and the outstanding opportunity we have to grow on the solid foundations of success the Bond family has established in New England.

Over the course of our history, we’ve proven our ability to very effectively acquire existing store chains, implement our dual market strategy and instill the O’Reilly culture in the new store teams. One of the best results of these acquisitions have been the outstanding leaders we’ve added to
our team. In fact, many of the members of our senior management team have joined O'Reilly as a result of a prior acquisition and we are confident that we are building a great team in the Northeast.

I will close my comments by again congratulating Team O'Reilly on their strong performance in 2016. Our team continues to set the standard for our industry and our most difficult competition every year is outperforming the high bar we've set for ourselves. Every day, we must continue to provide unwavering customer service that surpasses expectations and continues to earn our customers' business. And I am confident we have the team in place to out hustle and out service our competitors and take market share again in 2017. Now I will turn the call over to Tom.

Tom McFall - O'Reilly Automotive Inc. - EVP & 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 fourth-quarter results and provide some additional guidance for 2017. For the quarter, sales increased $150 million comprised of a $91 million increase in comp store sales, a $59 million increase in non-comp store sales, a $1 million increase in non-comp non-store sales and a $1 million decrease from closed stores.

For 2017, we are establishing our full-year total revenue guidance at a range of $9.1 billion to $9.3 billion. For the quarter, gross margin was 53.1% of sales and improved 35 basis points over the prior year, in line with our expectations as we continue to realize the benefit of acquisition cost decreases we secured earlier in the year and the LIFO headwind was minimal in the fourth quarter. For the year, gross margin was 52.5% of sales, an improvement of 22 basis points over the prior year. This was right in the middle of our beginning of the year guidance of 52.3% to 52.7% as we benefited from better-than-expected acquisition improvements and leverage on distribution costs offset in part by full-year LIFO headwinds of $49 million, which exceeded the prior-year amount by $21 million.

Looking forward to 2017, we expect gross margin to be in the range of 52.8% to 53.2% of sales. The improvement is a result of anniversarying the significant LIFO headwinds in 2016 with a lower expected LIFO headwind in 2017 while annualizing the acquisition improvements from the last year. We assume pricing in the industry will remain rational.

Our effective tax rate for the year was 36.6% of pretax income, which was in line with our expectation. Looking at 2017, we expect our tax rate to be approximately 37% for the year with the increase driven by a lower amount of benefit from certain work tax credits. On a quarterly basis, we expect the rate to be relatively consistent with the expectation of the third quarter being slightly less as 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 pre-existing job tax credit programs.

For the year, free cash flow was $978 million, which was a $111 million increase from the prior year driven by increased income and a larger decrease in net inventory. Our guidance for 2017 is $930 million to $980 million, which, at the midpoint, is slightly below our strong 2016 results as we expect the decrease in our net inventory investment on a year-over-year basis will be less offset in part by our planned increase in net income.

Moving to inventory per store. At the end of the quarter, it was $575,000, which was flat compared to the end of 2015. 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 are pleased with the management of our inventory in 2016. However, as Greg discussed earlier, we finished the year on a strong sales trend, which put us in a favorable inventory position at the end of the year. Accordingly, for 2017, we expect our per-store inventory to increase by 1.5% to 2%. This growth rate is still below our comparable store sales growth estimate and we expect to continue our success of effectively deploying inventory in 2017.

Our AP to inventory ratio finished the fourth quarter at 106%, which was an increase of 7% over the prior year as we benefited from incrementally improved terms and solid (technical difficulty) volumes. For the year ended 2017, we expect to see a marginal improvement in our AP to inventory ratio to approximately 107% as we incrementally improve our vendor terms, but face structural impediments to further significant increases in our AP percentage.

Capital expenditures for the year ended up at $476 million, which was right in the middle of our guidance. For 2017, we are forecasting CapEx at $470 million to $500 million. The minor increase is driven primarily by the conversion of the acquired Bond stores, increased investment in our over-the-road vehicle fleet and store technology infrastructure upgrades offset in part by a reduced number of new stores.
Moving onto debt, we finished the fourth quarter with an adjusted debt to EBITDA ratio of 1.63 times, still well below our targeted range of 2 to 2.25 times. We continue to believe that our stated range is appropriate for our business and will move into this range when the timing is appropriate. We continue to execute our share repurchase program and for the calendar year 2016, we repurchased 5.7 million shares for an aggregate investment of $1.5 billion at an average share price of $264.21.

Since the inception of our buyback program through yesterday’s earnings release, we’ve repurchased 57.9 million shares for an aggregate investment of $7.1 billion at an average share price of $122.91. 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 higher rate of return and we will continue to prudently execute our program with an emphasis on maximizing long-term returns for our shareholders.

Finally, I would like to once again 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’d like to ask Richard, the operator, to return to the line and we will be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

Matt Fassler - Goldman Sachs - Analyst
My first question relates to tax refunds and the cadence thereof. Is this something that you think may have started to impact your business quarter-to-date at this stage and is your sense that any changes in timing are essentially resolved by the end of the March quarter?

Tom McFall - O’Reilly Automotive Inc. - EVP & CFO
Yes, I think it is something that late in the quarter so far has had some impact because the early filers, which are generally the most economically incentivized customers to get their money as quick as they can, that we would have seen some benefit in that last year towards the end of January, first of February and we have not seen that yet because of the delay. I think most of that trues up before the end of the quarter, but I don’t really know for sure, but I would suspect that most of it trues up by the end of the quarter.

Matt Fassler - Goldman Sachs - Analyst
Got it. And then just a quick follow-up. This relates to LIFO. It sounds, Tom, like LIFO was I think you said negligible in Q4. Obviously, it’s had some impact in understanding the cadence of gross margin pretty consistently over the past several years. As you think about the outlook for 2017, based on what you see for pricing, based on raw material costs, should this be close to a zero for the year or more like close to what we had seen in prior years ex that bulge that you had in early 2016?

Tom McFall - O’Reilly Automotive Inc. - EVP & CFO
We still have a few opportunities that we are working on and a couple of them are pretty significant that we know about right now. Our expectation is that we are going to see be about half as much LIFO headwind in 2017 as we saw in 2016.
Matt Fassler - Goldman Sachs - Analyst
That’s comparing against 2016 as reported with those couple of big numbers?

Tom McFall - O’Reilly Automotive Inc. - EVP & CFO
Correct.

Matt Fassler - Goldman Sachs - Analyst
Great. Okay, thank you so much, guys.

Operator
Michael Lasser, UBS.

Michael Lasser - UBS - Analyst
So your guidance assumes that comp trends will accelerate as you move out of the first quarter. Aside from the weather and slightly easy compares and maybe some of the tax issues, is there anything else that you see that should drive the acceleration? There’s going to be some snow in the Northeast in the next day or two, but if this is the last blast of winter, how long will that act as an overhang for the industry?

Greg Henslee - O’Reilly Automotive Inc. - President & CEO
We had some pretty good winter weather in December, so I don’t think that the lack of winter, if we don’t have much more winter weather, would be as potentially impacting as it was related to last winter. So we would expect it to be able to more of a normalized spring and summer related to winter weather. But, like we said, we still have a month of winter to go, so it’s yet to be seen, but there are some pretty mild trends going on.

Our expectation is that the fundamentals of our industry, our confidence in our ability to continue the cadence that we are on from a comp store sales perspective under more normalized conditions where we are not comparing to these tax delays and stuff like that that we are in, that we will get back to a comp store range that would be in that 3% to 5% range and that we feel confident at this point that for the year that we would end the year in that range.

Michael Lasser - UBS - Analyst
And my follow-up question is, Greg, you’ve been around the industry for a long time and there’s, obviously, a lot of attention on some of the emerging competition within the space. What measures are you watching to ensure that the marginal demand for the industry, particularly on the DIY side, isn’t moving online and becoming more sensitive to price transparency? If that becomes a risk, how do you expect to see it?

Greg Henslee - O’Reilly Automotive Inc. - President & CEO
Well, I’ve been a little surprised by the interest that there’s been in a transition to online recently. We’ve not seen much in our business that’s led us to be very concerned about it, but we have read a lot of the reports and I saw the thing in the New York Post and stuff like that. There really hasn’t been a lot changed on our end. Our best barometer of that is we have a lot of field guys that me and Jeff and Greg and Tom and every one on our management team know very well and we encourage them to be outspoken with us about competitive pressures that they feel and we have just not seen a change in that competitive pressure. Customers would tell you or you would hear things from them about their concerns, things like that.
We are in a business, and I don’t want to go into a lot of detail about the things that we bring to the table that maybe an online retailer wouldn’t, but these online retailers have been around for a long time and I realize that Amazon is the strongest and the best run. I, obviously, have a lot of respect for them and I am a customer for household items and other things. But one of the things that -- or some of the things that are a barrier to entry for these guys are that we are in a very technical business. Let’s talk about the DIY side for a minute. When a customer has a problem with their car, whether it is a -- their car won’t start, let’s say. They don’t really know what’s wrong; they know it could be either a battery, or alternator or a starter motor. If they can jumpstart their car or somehow get it to our store, we are going to be able to tell them what’s wrong. We will go out of the store and test it. We will help them install a battery. We will get them lined up with a technician to help solve their problem if they can’t. Many times their problems are what I call drivability problems. They are related to sensors or emission system things that cause the check engine light to come on or a variety of things.

We have highly experienced trained professionals in our stores to help them solve these problems. Many times, customers, when they come in to buy a part, they don’t really know what the part is called. They think it’s bad, it looks bad. We will test it for them. We may lead them down another path. It’s a highly technical business. And then on top of all that, learning and developing the science to know what inventory you need in different markets takes time and experience and that’s the reason that our Company -- one of the reasons we’ve done so well is because we’ve been so good at that. Plus there’s almost 36,000 part stores in the US. It’s very convenient to get parts and there is a high immediacy of need when you have a car problem. Not that there aren’t accessories and other things that can wait and do.

On the professional side, which there’s been some talk about what an online retailer can do on the professional side, and gosh, I just see that so difficult for them to penetrate when I think about the relationships that we have with our professional customers and the dependency that they have on us to provide them training and guidance and access to tools and the equipment to keep their tools running and their equipment running and how quickly they need parts and how if they are not sure maybe of a model year change where a car might take one of two parts, we will send them both, then bring the other one back. We will match up parts for them. The list goes on and on of the things that we do. Plus we are making a distribution center inventory available to them in many markets, six, eight times a day, which is -- I think that the online retailers, while they’ll, as they have proven over the years, they will continue to take a little bit of market share here and there. I don’t see them nearly as one of our most prominent competitors.

**Michael Lasser - UBS - Analyst**

Thank you very much.

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**Operator**

Carolina Jolly, Gabelli.

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**Carolina Jolly - Gabelli & Co. - Analyst**

Thanks for taking my call. After that question, I really wanted to ask if you have any data around where you are taking share because it really seems like you are able to take share. And if you can direct any of that comment to the do it for me versus the do it yourself segment.

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

Well, I think the do it for me business is growing a little faster than, on a macro basis, than the DIY business and considering that we are comping about the same on both, I would speculate that we are gaining a little more share on the DIY side right now than we would be on the do it for me side. Geographically, we perform well in many markets. Generally speaking, where we are growing the fastest are in our expansion markets like in the Southeast and the Northeast in areas like that where our stores are newer and we have more to gain from competitors who have business already and we are in there trying to get what business we can. So I would say in those markets is where we are gaining most of the market share.
Carolina Jolly - Gabelli & Co. - Analyst

Thanks. And just to follow up on that, a lot of the data that has also been spoken about is that you have better fill rates. I don’t know if you are able to speak to that, but are you also able to gain share through those better fill rates? And previously you had spoken about, I guess, picking up do it for me talent. Do you have any comments around that?

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

Yes, I think we have an incredible fill rate. Our business is built around this high availability model, making sure that we have a lot of SKUs available on a same-day basis multiple times a day and I think we are the best in our industry at making a wide array of parts available to our customers and it’s one of the reasons that our Company has done as well as it has over the years and this goes way, way back. This is not a new thing. I think when the O’Reilly family was running the business as a small company, they quickly recognized that if you have a part and you can get it to the customer quicker than everybody else that you are going to win.

When it comes to talent and recruiting, the second part of your question was about that, I think that we are a desired employer. I think that people that know parts and are good parts people, they like to work for us. We equip them with the tools that they need to be successful and one of the most important tools that we have put them with is this availability that we are talking about. It’s hard to be a great parts person if you don’t have access to the parts and we put our professional parts people in a position to where they have excellent access to a wide array of parts to take care of our professional customers and our DIY customers.

Carolina Jolly - Gabelli & Co. - Analyst

Thank you.

Operator

Mike Baker, Deutsche Bank.

Mike Baker - Deutsche Bank - Analyst

Wanted to ask you a couple questions on pricing. First, you said you are not expecting or don’t have any inflation in your comp estimates, but what about inflation on oil and other liquids and lubricants? Shouldn’t we expect some inflation there and if so, will that help incrementally to your comp guidance?

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

Tom will take that.

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

We are not very good at projecting our commodity costs. To the extent that we do see some increase, we would expect to see some increases as oil prices go up and we have some LIFO headwinds from reducing acquisition costs on hard parts that we would expect to net out, but we don’t anticipate seeing a wide enough effect on products to have inflation help drive our comparable store sales this year.
Mike Baker - Deutsche Bank - Analyst
And so I guess similarly there wouldn’t then be much impact on your gross margins from that type of inflation?

Tom McFall - O’Reilly Automotive Inc. - EVP & CFO
Correct.

Mike Baker - Deutsche Bank - Analyst
Okay. Then on the other side as it still relates to pricing, I hear what you’re saying about online competitors perhaps not taking a lot of market share, but do you still think that, with the price visibility, that’s increased now from some of these competitors that there is no pricing pressure? I understand that consumers need to come into your stores for the advice and whatnot, but do you expect to see consumers come in with pricing from Amazon and insist you guys match that price?

Greg Henslee - O’Reilly Automotive Inc. - President & CEO
I think that, over time, as price transparency on equivalent product continues to increase that that’s likely to happen. I think it happens some today and we equip our team members with how to deal with that. We don’t let a customer that needs a part leave our store without that part in their hand.

Mike Baker - Deutsche Bank - Analyst
So at this point, is there any hit from that incorporated in your gross margin outlook or is it too small to matter now? So how should we think about that ongoing?

Tom McFall - O’Reilly Automotive Inc. - EVP & CFO
It’s too small to matter now.

Mike Baker - Deutsche Bank - Analyst
Okay. Appreciate the color.

Operator
Dan Wewer, Raymond James.

Dan Wewer - Raymond James - Analyst
Greg, the greenfield store growth rate slows in 2017. Is that a signal that O’Reilly wants to maintain the flexibility or the capacity to make additional acquisitions such as Bond in the upcoming year?
Greg Henslee - O'Reilly Automotive Inc. - President & CEO

Well, really moving to 190 was simply to better accommodate the integration of Bond with the teams that we have to put in new stores. But, as you know, Dan, we are opportunistic and somewhat aggressive right now with looking at companies that we feel like would be good fits for us and there’s several of the smaller regional players out there that many would fit well in our geography and fit well in our business. So, yes, we are in a good position to continue our strategy of acquiring companies that make sense for us in 2017 and beyond.

Dan Wewer - Raymond James - Analyst

I know during the past couple of years you’ve talked about the difficulty in securing real estate in the Northeast. Has that eased up any for you?

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

Well, it’s a challenging real estate market. There is no open retail lots just waiting for us to come along, so you have to be pretty creative in the way you put in new stores. Then, of course, cost is a factor, so you have to be a little more confident sometimes in the amount of volume that you can do in a location if you're going to take on the rent that it sometimes takes up there.

But I think we have learned a lot as we’ve explored the Northeast and bought real estate and I think our position up there is incrementally improving, but no question real estate is tough up there. It makes it a little more advantageous for us to consider some of the acquisitions that we could potentially make up there as exemplified with what we did with VIP and now with Bond.

Dan Wewer - Raymond James - Analyst

And just a follow-up question. The vehicle miles driven data the last couple of years has shown a lot more strength in the Western markets than in the Upper Midwest and the Northeast and that seems to be correlating with industry sales trends as well. Would you expect a reversion to the mean where the Upper Midwest and Northeast industry trends would improve relative to the West going forward?

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

Dan, I don't know. It's always tough to determine the drivers of miles driven differences between regions of the country. Tom or Jeff, I don’t know if you guys have an answer to that, but I don’t really have a good opinion on that.

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

What we would tell you is that the accuracy of that data, while we think it directionally is a very good barometer for us, the regional exact miles are -- a lot of estimations go into that calculation. From a long-term perspective, I think it has more to do with where is the population growth in the US and that ultimately will drive the miles driven differences in regions.

Dan Wewer - Raymond James - Analyst

That’s a good point. Thank you.
Alan Rifkin - BTIG - Analyst
Thank you very much. Tom, could you maybe provide a little bit of color with respect to the free cash flow guidance for 2017, why, even at the high end, that would be flat versus 2016? Why would it not continue to grow in 2017 and beyond? Then I have a follow-up, please.

Tom McFall - O'Reilly Automotive Inc. - EVP & CFO
The key difference there is just the expected year-over-year increase in our AP to inventory ratio that we saw 7% increase in 2016 over 2015 and our expectation is that, while we will increase it somewhat, we won't see that 7% increase. Therefore we won't drive as much reduction in working capital.

Alan Rifkin - BTIG - Analyst
Okay. And then my second question, if you can maybe provide, Greg, an update on what’s happening in South Florida, how many stores you have there today, how many you forecast of the 17 openings? And then also as a wider picture, certainly, Jeff and Greg’s promotions are obviously well-deserved and congratulations, gentlemen, but, Greg, does this signal any intention on your part to do anything different with your longer-term career at O'Reilly?

Greg Henslee - O'Reilly Automotive Inc. - President & CEO
Okay, I will answer that question first, then talk about Florida. It really is recognition of the leadership roles that these two individuals play in our Company. They do a great job. I will be 57 years old, so I won't be CEO forever, but I have no immediate plans to not be CEO. And when that time comes, it will be announced and we will do it the right way. I don’t think that long term I can't foresee a time that I wouldn’t be involved with the Company right now. So we are talking down the road if anything were to happen. So I wouldn't relate anything that we've done here with Greg and Jeff to something like that.

In Florida, today, we have 163 stores, most of which are supplied out of Orlando. We continue to progress South. We've got stores bumping up against Fort Lauderdale and Miami, Fort Myers. So our expansion in that area has been significant and very successful. We continue to have great success with the new stores we've opened down there. We've been very fortunate for some time now to have had a great team of auto parts guys down there that are able to recruit good auto parts guys and we have some strong regional competitors down there that we feel like we've done well against. So we continue to grow and have continued expansion plans down there this year. A material part of our new store openings this year will be in Florida.

Alan Rifkin - BTIG - Analyst
Okay. Thank you very much.

Operator
Seth Basham, Wedbush.

Seth Basham - Wedbush Securities - Analyst
Thanks a lot. Good morning and congratulations to Jeff and to Greg. My question is around omnichannel. You mentioned that you're ramping up some investments in information systems. Can you speak more broadly about where those are and what your omnichannel strategy is going forward?
Tom, do you want to take that?

Sure. When we look at our investments in IT, it's across a broad spectrum of things. We are going to launch a new website here beginning of the second quarter, which is the step in the right direction for us from an omnichannel standpoint. Our real goal is to make sure that we have a seamless transaction however our customers would like to start the transaction. Often in our business, it starts with looking up a part online, finding out what you might need, what the availability is, making sure that we can transition the start of that transaction and pull it up in the store, make sure we identify the customer, make sure we can maintain visibility of what type of vehicles they work on and really maintain that connection with the customer. As Greg talked about earlier, our customers are primarily coming to our store for advice, so if they start online, we want to be able to continue that transaction in the store.

That's helpful. As a percentage of your business, where is it now and where do you think it will be in five years in terms of the transactions that are started online?

It continues to be a relatively small portion where right now we are tracking primarily order online pick up in store. Our opportunity there is to better tie when our customers are looking at availability and looking up parts and getting information on how to repair their vehicles -- obviously, it's primarily the DIY side -- and making sure we maintain that data for when they come into the store. Right now, if they don't actually transact online, we are not capturing that when they walk in the store. But a high percentage of our customers are investigating their fixes online.

And Seth, if I can just add something to that. A pretty material part of our B2B business is transacted online and has been for some time. We were one of the first companies to go to an online type of ordering platform back pre-Internet. We did it using what they call ASCI terminals back in the day at 1200 baud modems and it worked for us. And so we've continued to build on that and today, a material part of our B2B business is transacted online.

Got it. Thank you, guys.
projects calm and steadiness. I just wanted to get a sense is there anything we are missing. Underlying trends seem fine. You talked about miles driven staying healthy. Can you assess current state, anything you haven’t said already?

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

I think I’ve said everything. We were just chatting amongst ourselves here before the call wondering if we’d be asked about Amazon because it’s just something – we were at our annual meeting with our store managers this week and we talked about a lot of things. We have a lot of tough competitors. I have yet to have anyone talk to me about Amazon as a competitor or online competitors. And I know that they are, but it’s just not a big factor right now from a competitive standpoint, not that it can’t be in the future and I obviously have a lot of respect for the great company that they have build there and again, I am a customer like most people. I think the things we talked about, just the tough year-over-year compares first quarter, mild weather in January and this delay in tax refunds are the reason that we have the 2% to 4% comp guidance for the first quarter. And I would refrain from reading more into it than just that.

**Simeon Gutman - Morgan Stanley - Analyst**

Okay. And then I don’t know if this was asked, but if you look at your next year, full-year guide and the composition of industry growth versus marketshare, you mentioned higher gas prices could pinch demand a little. I don’t know if that I guess 3 to 5 is still intact, but does anything change in how you expect the industry to grow versus how much share you expect to gain in 2017?

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

No, I think the cadence of industry growth and I think our success in taking marketshare, in addition to that growth, is pretty comparable in 2017 versus 2016. The challenge for our industry ongoing and this gas been a challenge for some time now is that as cars become more complex, we have to work harder to make sure that we are in a great position to keep customers that have cars out of warranty from going back to the dealers and choosing an aftermarket shop who buy parts from us and our competitors.

So I think that, as an industry, we have got to continue to work to keep that business coming our way because as the cars become more complex, it becomes more and more difficult to build these parts and so forth. I think our industry has done great, but when I talk to our suppliers tonight, that will be one of the things I talk to them about is just the investments that we all have to make in making sure that we are in the best position we can possibly be to compete against our real competitors in the aftermarket and that is the OE dealers.

**Simeon Gutman - Morgan Stanley - Analyst**

Okay. Thanks, Greg.

**Operator**

Brett Jordan, Jefferies.

**Brett Jordan - Jefferies & Co. - Analyst**

To that last question, your response that the cadence of industry growth in 2017 comparable to 2016, wouldn’t it be more similar to 2012 where we had a very weak winter and we had a weak year in 2012 then some pickup in 2013? You don’t think we are going to see acceleration in 2017 industry-wide?
Greg Henslee - O'Reilly Automotive Inc. - President & CEO

I am hopeful we do, Brett, and I agree with you that it probably would be a little more comparable to that, but when we talk about industry growth, I usually rely on what the associations project and so far, the people I've talk to at the various associations are projecting growth similar to what we would have seen last year. Tom, you may have some input on that?

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

Brett, what I would tell you is that when we look back at 2016, the second and third quarters were, they were solid quarters for us. When we go back to 2012, they were a little bit weaker than that. So that's why we think we are going to be more of a consistent basis and that's why we've given 3% to 5% guidance versus the comparison to 2012.

Brett Jordan - Jefferies & Co. - Analyst

And that leads to another of my questions. On 2014, you talked a couple times about the marketshare gain on Q4. How did you see the underlying industry growth versus your comp? It seemed like the industry certainly didn't grow as well as you did last year, but do you have a feeling for what the spread might be marketshare versus just the rising tide?

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

Do you have a comment on that, Tom?

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

We are going to watch and see how other people in the industry do here later in the month and maybe we'd have a better answer for you.

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

Brett, I don't mean to oversimplify this, but I always look at what the associations say about industry growth and various indicators you can get through industry associations and so forth, but my most direct comparison is with our publicly traded competitors and privately owned companies, some of which I know the principles, finding out how they are doing and comparing it to how we did. And as you can see, that comparison has led us to the conclusion that we have gained quite a bit of marketshare over the last few years and under existing circumstances, I see no reason to think that that won't continue for 2017.

Brett Jordan - Jefferies & Co. - Analyst

Okay, great. And then one last question. I think in your prepared remarks you said that the gap in regional performance had ceased to exist. Is that the case? And I guess as we look at what we've seen in January, are we, just because we have lost some of the winter in the Northeast, seeing a little bit of a slide back up here or is there anything meaningfully going on in different regions?

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

Well, we always have regional variations for a number of reasons, including the age of stores that exist in some regions versus others and things like that. What we were saying is that the difference that we felt like was driven by winter-sensitive markets or weather-sensitive markets as compared to those that might not be so weather-sensitive, that towards the end of the quarter, we saw that gap go away. To the extent that we have mild weather continue through the remainder of the winter, we would expect to see some of that gap come back.
Brett Jordan - Jefferies & Co. - Analyst
Okay. Great. Thank you.

Operator
We have 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 Inc. - President & CEO
Okay, thank you, Richard. We would like to again conclude our call by thanking the entire O'Reilly team for our strong 2016 results. We are pleased with our solid fourth-quarter and full-year results and we remain extremely confident in our ability to continue to aggressively and profitably gain marketshare in 2017. I would like to thank everyone for joining our call today and we look forward to reporting our 2017 first-quarter results in April. Thank you.

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

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