

# O'Reilly Automotive, Inc.

<b>Recommendation</b>	<b>BUY</b>
<b>Target (today's value)</b>	\$240
<b>Current Price</b>	\$222.04
<b>52 week range</b>	\$144.38 - \$230.77

Share Data	
Ticker:	ORLY
Market Cap. (Billion):	\$22.5
Inside Ownership	2.7%
Inst. Ownership	93.4%
Beta	1.36
Dividend Yield	N/M
Payout Ratio	N/M
Cons. Long-Term Growth Rate	15.4%

	'12	'13	'14	'15E	'16E
Sales (billions)					
Year	\$6.2	\$6.6	\$7.2	\$7.8	\$8.5
Gr %	6.8%	7.6%	8.5%	9.0%	8.9%
Cons	-	-	-	\$7.8	\$8.3
EPS					
Year	\$4.83	\$6.14	\$7.46	\$8.63	\$9.74
Gr %	28.2%	26.9%	21.6%	15.6%	12.9%
Cons	-	-	-	\$8.56	\$9.72

Ratio	'12	'13	'14	'15E	'16E
ROE (%)	23.7%	32.9%	39.1%	40.0%	36.5%
Industry	19.6%	18.5%	18.4%	19.6%	22.2%
NPM (%)	9.5%	10.1%	11.4%	11.3%	11.6%
Industry	3.35%	3.27%	3.8%	4.00%	4.3%
A. T/O	1.10	1.13	1.14	1.15	1.12
ROA (%)	10.4%	11.3%	12.3%	13.0%	13.1%
Industry	6.39%	5.75%	5.28%	5.83%	5.95%
A/E	2.27	2.90	3.16	3.09	2.79

Valuation	'13	'14	'15E	'16E
P/E	21.3	25.24	25.7	22.8
Industry	18.8	21.0	18.8	16.7
P/S	2.1	2.8	2.8	2.7
P/B	6.9	9.7	10.5	10.0
P/CF	15.8	17.2	19.0	17.2
EV/EBITDA	11.5	14.2	13.9	12.9

Performance	Stock	Industry
1 Month	3.1%	0.0%
3 Month	18.5%	7.1%
YTD	15.3%	2.5%
52-week	50.1%	25.5%
3-year	109.7%	72.9%

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Source: FactSet Prices

**Summary:** I recommend a buy rating with a target of \$240. Even though this only represents a 10% upside, I am bullish on the outlook for ORLY based on its fundamental and valuation metrics. ORLY is fairly priced using DCF intrinsic value; however, my target price reflects a relative P/S multiple which has a 96% R-squared with net profit margin to the industry.

### Key Drivers:

- **Miles Driven:** With lower average gas prices, miles driven will begin to rise resulting in an increased demand for automotive replacement parts.
- **Average Age of Vehicles:** The average age of vehicles has been climbing in recent years. Average vehicle age was unchanged at 11.4 for 2014; however, it could rise to 11.7 by 2019 and is up from 9.6 in 2003.
- **Opening New Stores & SSS:** ORLY will grow its store base by 4.7% in 2015 and I am also modeling for strong SSS at 6.8%.
- **Unemployment:** Unemployment levels have been consistently falling for several years now and are leading to an increase in consumer spending from which ORLY is benefiting.

**Valuation:** On a DCF basis, O'Reilly is fairly priced, as the intrinsic value is about \$225 and the shares currently trade at \$222. Although, using a P/S multiple, O'Reilly is worth about \$238.

**Risks:** Threats to business include deteriorating economic factors, a competitive market place, regional and weather patterns, and decelerating growth.

## Company Overview

O'Reilly Automotive, Inc. is one of the largest specialty retailers of automotive aftermarket parts, tools, supplies, equipment, and accessories in the United States. It sells products to both do-it-yourself (DIY) and professional service provider customers (DIFM)—also known as O'Reilly's "dual market strategy." The business was founded in 1957 and is now headquartered in Springfield, Missouri.

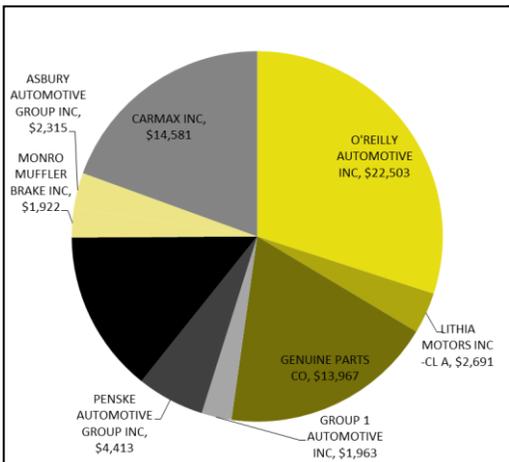
As of December 31, 2014, O'Reilly operated in 4,366 stores in 43 states. The O'Reilly stores carry an extensive product line, including the products identified below:

- New and remanufactured automotive hard parts, such as: alternators, starters, fuel pumps, water pumpers, brake system components, batteries, belts, hoses, temperature control, chassis parts and engine parts.
- Maintenance items, such as: oil, antifreeze, fluids, filters, wiper blades, lighting, engine additives and appearance products.
- Accessories, such as: floor mats, seat covers and truck accessories.

O'Reilly focuses on its' "dual market strategy", superior customer service, technically proficient store personnel, and a strategic distribution system. O'Reilly also is a growth driven company with an aggressive new store expansion rate. O'Reilly opens new stores by building in high density and growing population areas, acquiring existing locations, and buying multi chain auto parts stores.

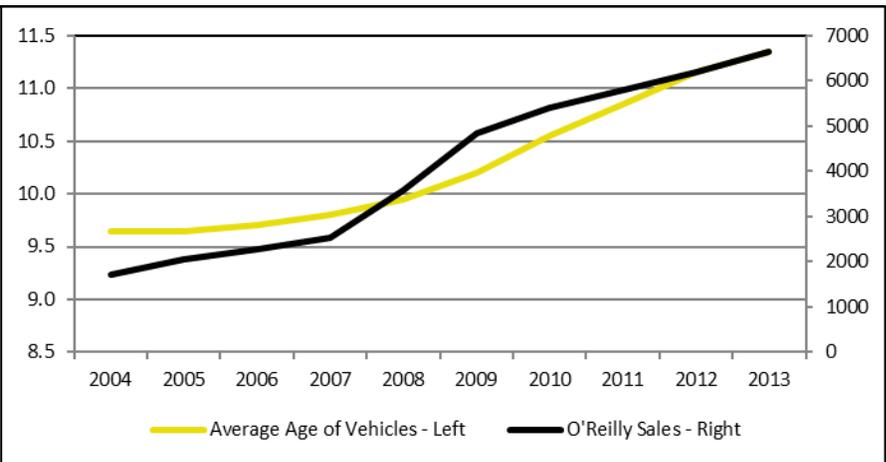
O'Reilly has been able to continually grow average store sales while aggressively opening new stores. Since 2012, total sales have grown at an average 7.6% and SSS have averaged 4.9%. Also, O'Reilly is made up of an extensive team of experienced management which has helped it become one of the largest aftermarket part suppliers in the United States currently holding a 30% market share among its closest seven competitors.

Figure 1: Market Value In Millions



Source: Factset

Figure 2: % Increase in Average Sales



Source: Company Reports

**Business and Industry Drivers**

Though several factors may contribute to O’Reilly Automotives’ future success, the following are the most important business drivers:

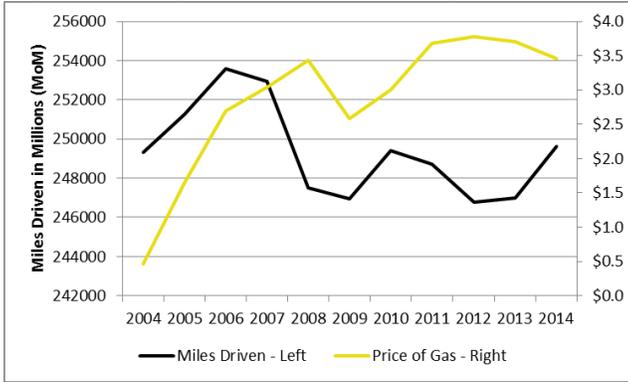
- 1) Miles Driven
- 2) Average Age of Vehicles
- 3) Opening New Stores
- 4) Same Store Sales
- 5) Unemployment

Main Drivers of O’Reilly’s Stock

Miles Driven

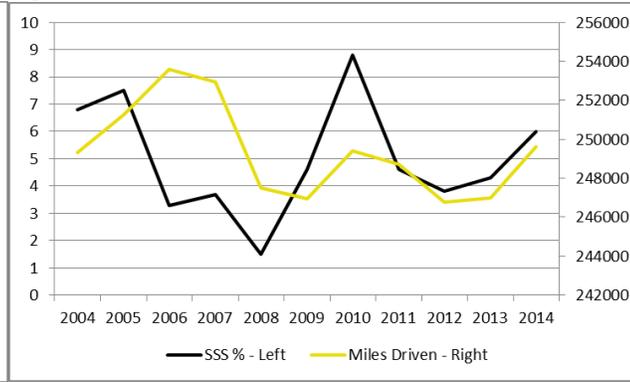
The number of total miles driven by US consumers will determine their need for maintenance and aftermarket parts sold by auto parts stores. As shown below in Figure 4, average miles driven were steadily increasing into 2007. Since then, the average miles driven have remained somewhat flat. However, with the recent drop in gas price, total miles driven in Q1 were up 3.9% from Q1 2014.

**Figure 3: Average Miles Driven vs Average Price of Gas**



Source: Bloomberg and DOE

**Figure 4: SSS vs Miles Driven**



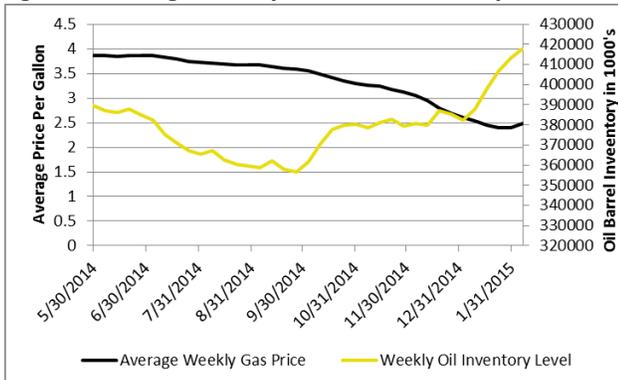
Source: Bloomberg and DOE

Average miles driven have fluctuated constantly for the past several years, but have remained below their highs in 2006 and 2007. This is most likely a result of the recession in 2008, which caused a jump in unemployment, as well as a high increase in average gas prices. In Figure 4, data shows that SSS are strongly correlated with miles driven.

Gas prices influence miles driven which drives demand for auto parts

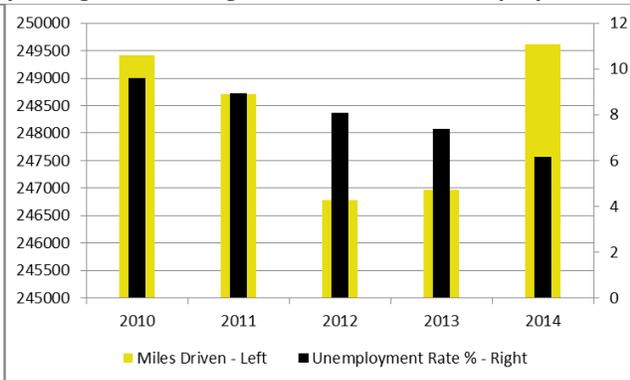
As shown in the Figure 6 below, during the last five years while unemployment has fallen, average miles driven have begun to increase. With unemployment now sitting at just 5.5%, more consumers can afford to drive vehicles, which will directly affect the average miles driven. The exception was in 2011 and 2012 as gas prices rose.

**Figure 5: Average Weekly Gas Price vs Weekly Oil Inventory**



Source: Bloomberg and DOE

**Figure 6: Average Miles Driven vs Unemployment Rate**



Source: Bloomberg and DOE

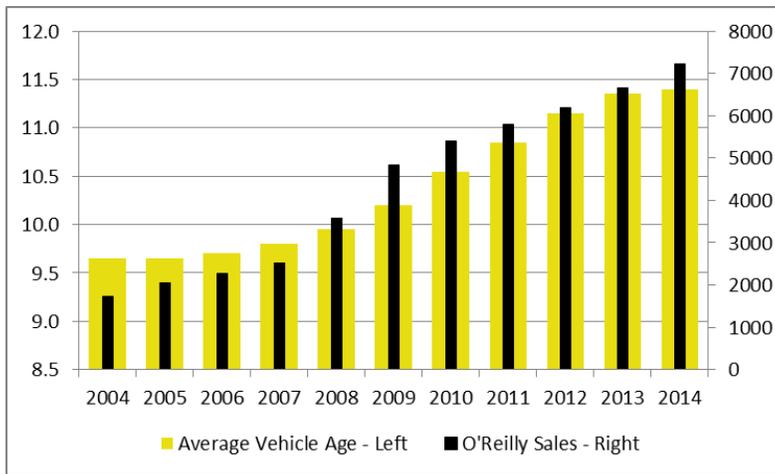
Due to record levels of oil supply, gas prices may remain low and consumers will drive more miles

In Figure 5, the data illustrates the relationship between US gas price and oil inventory levels. Since September 20, 2014, oil inventory levels have risen about 17.2% and gas prices have simultaneously fallen -30.9%. With oil inventories at all-time highs, gas prices could remain lower for the near future causing an upward trend in consumer miles driven. If employment continues to improve, and gas prices remain below recent historical averages, these conditions could cause consumers to drive more thus increasing the demand for aftermarket auto parts.

Average Vehicle Age

During the last decade, the average age of vehicles has climbed from 9.6 years in 2003 to 11.4 in 2014. Generally, the more a vehicle ages, the more replacement parts it will require. This trend may be a result of two potential factors: a decrease in new vehicle sales, or a greater reliability of vehicles allowing consumers to hold on to them longer.

**Figure 7: Average Age of Vehicles vs O'Reilly's Sales**



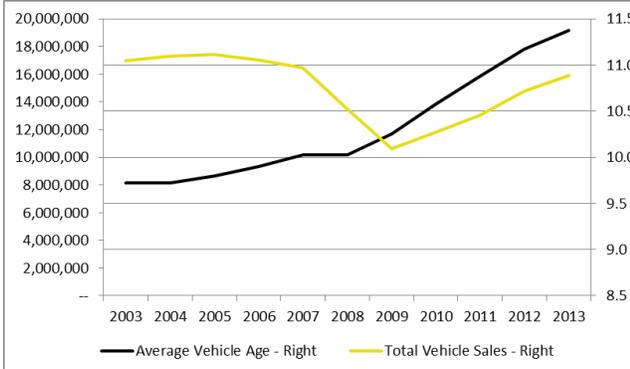
Source: Company Reports and Bloomberg

An increase in the average age of vehicles drives O'Reilly sales

From Figure 7, the data would suggest that the average vehicle age has been increasing due to a slowdown in vehicle purchases as a result of the recession in 2008. If that's the case, the recent uptick in vehicle purchases could begin to push the average age of vehicles down, thus reducing the need for replacement parts in the future. Vehicle reliability is also a factor.

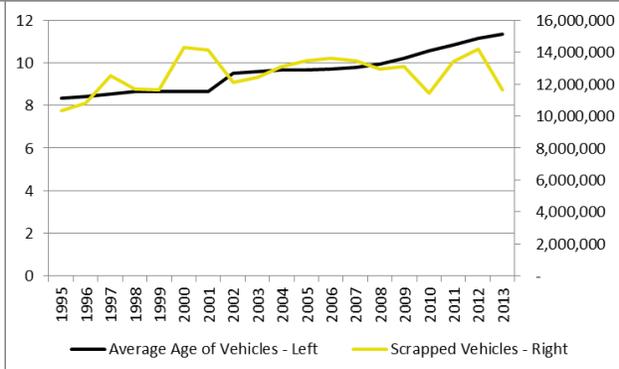
If vehicles can physically last longer, consumers may hold on to them for a longer period of time, but they may not need as many replacement parts as in the past. This could cause the illusion that an older fleet will cause more aftermarket parts to be purchased; however, if vehicles are more physically reliable, this may not be the case.

**Figure 8: Average Vehicle Age vs Vehicle Sales (US)**



Source: Bloomberg and DOT

**Figure 9: Average Vehicle Age vs Total Scrapped Vehicles**



Source: Bloomberg and DOT

Vehicle scraps rates are falling because cars are becoming more reliable

As Figure 8 shows, vehicle sales have rallied since 2009 and have increased 50% through 2013. Despite more vehicles being sold, the rate of scrapped cars is currently down 11.1% from where they were in 2009 but have settled in the range of 4.6% to 5.7% growth annually. If more cars are being purchased, and fewer are being scrapped, this could indicate that vehicles are becoming more reliable. If the average age of vehicles is increasing, it may be a result of improved reliability rather than consumer inability to purchase new cars. As a long term trend, this could begin to negatively impact O'Reilly if consumers don't need to repair their vehicles as often; however, O'Reilly believes that this will benefit them as customers will become more willing to invest in maintaining better built vehicles.

In addition, another benefit of the aging vehicle population is a larger percentage of vehicles are putting on more miles outside of the manufacturers' warranty limit. In general, vehicles out-of-warranty require a more significant level of maintenance and repairs.

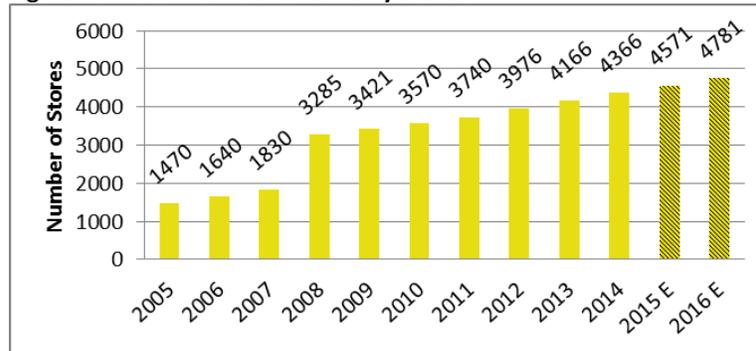
Opening New Stores

O'Reilly has an aggressive growth strategy in order to penetrate both emerging and existing markets. In 2008, O'Reilly acquired CSK Autos in adding 1,349 stores in 22 states in order to improve its market penetration. O'Reilly has grown 32.9% since the CSK acquisition and plans on continuing to aggressively open additional stores in the future. In 2014, O'Reilly met its' goal of opening 200 additional stores and is now forecasting 205 new locations in 2015, or 4.7% of the existing stores.

O'Reilly has 3 methods of opening new stores: 1) construct a new facility or renovate an existing property, 2) acquire an independently owned auto parts store, and 3) purchase a multi store chain. Some of the other factors considered when opening a new store include: population density, population growth patterns, demographic lifestyle segmentation, age, per capita income, vehicle traffic counts, and competing auto part stores within a predetermined radius.

Stores continue to grow at an average of 3.4% while firm increases average sales per store

**Figure 10: Total Number of O'Reilly Stores**



Source: Bloomberg and DOE

While aggressively opening new stores, O'Reilly has managed to improve average sales per store. Over the past five years, average sales per store have grown at 3.4% while opening stores at a rate of 4.9% for the same time period. This shows O'Reilly's ability not only to expand, but to grow existing store sales as well.

**Figure 11: Number of New Stores and Growth**

	2011	2012	2013	2014	2015 E	2016 E
# of Stores	3740	3976	4166	4366	4571	4781
New Stores	170	236	190	200	205	210
New Store Growth	4.8%	6.3%	4.8%	4.8%	4.7%	4.6%
Sales Growth Per Store	0.0%	4.0%	4.5%	6.3%	6.8%	6.8%

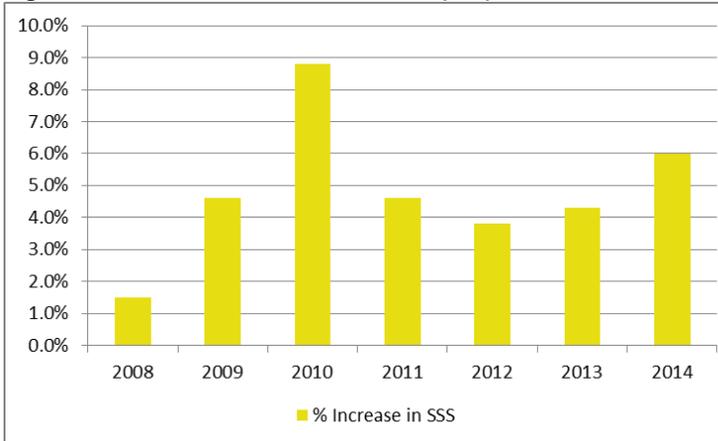
Source: Company Reports

Organic growth is a very key piece to O’Reilly moving forward. In a highly competitive market, O’Reilly has to keep pace with other large auto part providers such as Carmax, Advanced Auto Parts, Penske Automotive Group, and several other large chains in order to maintain its current market share. O’Reilly’s five year SSS growth is 5.5% compared to an average of 6% from its peers, however, that number is skewed by some of the competitors with a much smaller market cap.

Same Store Sales

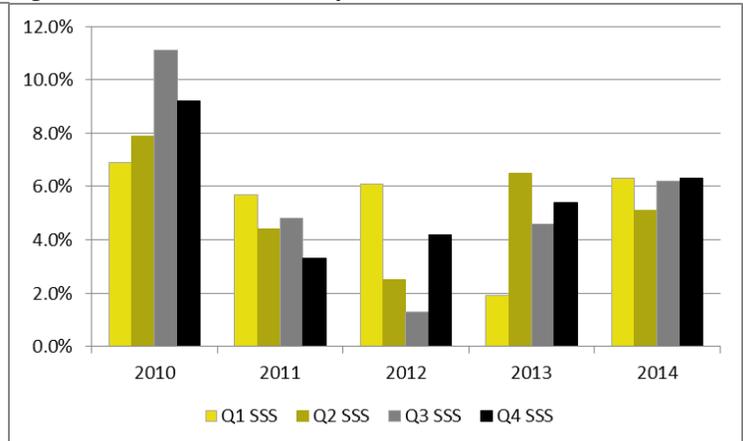
As previously mentioned, O’Reilly is focused on store growth in order to remain competitive in the auto parts industry. If O’Reilly continues to push to open new locations, it could cannibalize existing stores and same store sales could fall. That being said, it appears as though O’Reilly has been able to steadily increase store sales and open new locations at the same time. Since the CSK acquisition in 2008, O’Reilly has managed to open an additional 1,081 stores while continuing to grow same store sales.

Figure 12: Increase in Same Store Sales (SSS)



Source: Company Reports

Figure 13: Same Store Sales by Quarter



Source: Company Reports

Despite aggressive store growth, average sales per store have been increasing

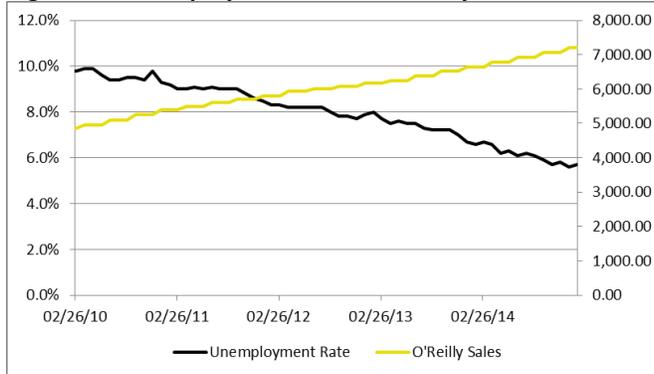
O’Reilly believes that in order to improve sales and profitability it must continue to strive to improve customer service. O’Reilly also prices its products very competitively using a “Good, Better, Best” system. Best quality products provide the highest profit margins. Although the margins are not specifically stated, ORLY mentions that the best quality tends to sell more when consumer confidence is high. Since consumer confidence has been on the rise in recent years, ORLY should benefit from selling its more expensive products. However, O’Reilly firmly believes that customer service is the most important driver of sales. For example, each store must be staffed with a “Professional Parts People” who has undergone extensive and ongoing training to be technically knowledgeable in order to better serve experienced customers who they deal with on a regular basis.

O’Reilly also has a “dual market strategy” which is a method geared towards serving both “Do it Yourself” (DIY-customer who buy parts directly) customers and “Do it for Me” (DIFM-professionals who buy parts from O’Reilly to service other individuals) customers. In 2014, O’Reilly derived approximately 58% of sales from DIY customers and approximately 42% from DIFM, which is the same as the 2013 numbers. O’Reilly also has a team of 600 full-time sales staff who are ready to service the professional service provider customer.

Employment

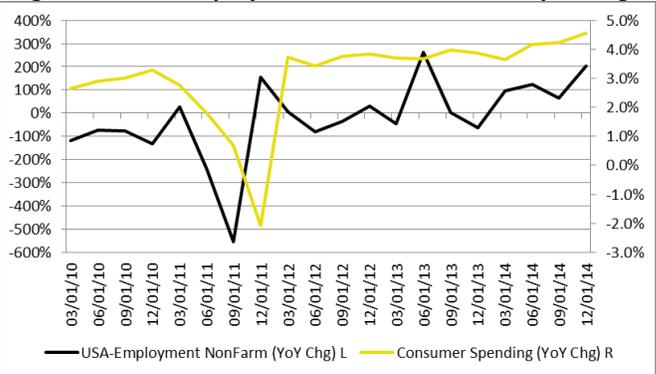
One of the most important drivers for O'Reilly's success is going to be employment. Employment will affect consumers' ability to purchase new vehicles, buy replacement parts, and even affect the amount of miles they drive. In December, unemployment hit a new low of 5.6%, which may indicate an improving economy. As unemployment fell (1.1%) in the last calendar year, US auto sales have risen 6.0% from 15,883,443 vehicles sold in 2013, to 16,841,973 in 2014.

**Figure 14: Unemployment Rate vs O'Reilly Sales**



Source: Bloomberg and Company Reports

**Figure 15: USA Employment Rate vs Consumer Spending**



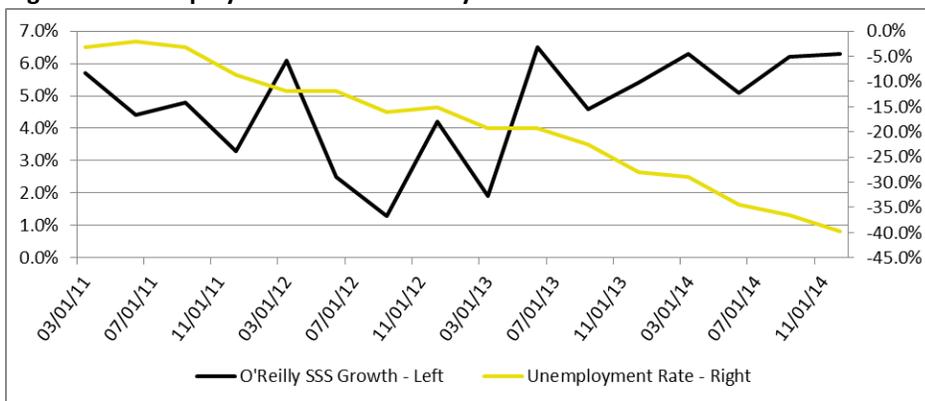
Source: Bloomberg

Unemployment levels dictate consumer's ability to spend which has a positive correlation with O'Reilly sales

If US auto sales continue to climb, it could negatively affect O'Reilly's sales as the average vehicle age is driven down. However, the climb in new vehicle purchases may be offset by the benefit from climbing consumer spending levels. Figure 15 shows that consumer spending has been rising as a result of an increase in employment. With more people employed, consumers should have excess disposable income that can be used to repair or service their vehicles and drive more miles.

Also shown in Figure 16 below, O'Reilly sales are inversely correlated with unemployment. From the period December 31, 2013-December 31, 2014, unemployment fell from 6.7% to 5.6%, while O'Reilly sales climbed 8.5%. This confirms that despite new vehicle purchases, O'Reilly benefits greater from the increase in consumer spending.

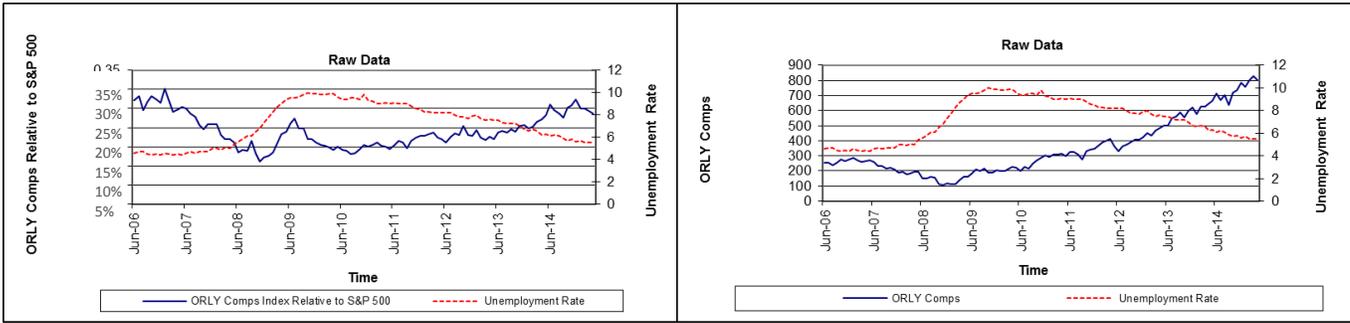
**Figure 16: Unemployment Rate vs O'Reilly Sales**



Source: Bloomberg and FactSet

Figure 17: ORLY Comps Rel. to S&P 500 vs Unemployment

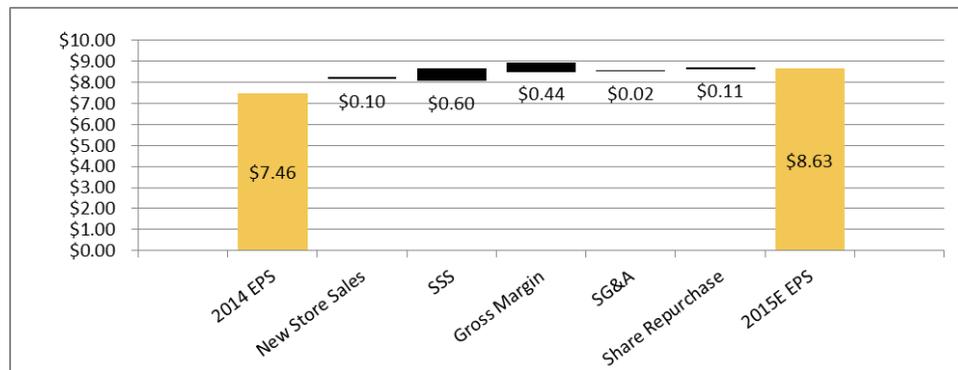
Figure 18: ORLY Comps vs Unemployment Rate



### Financial Analysis

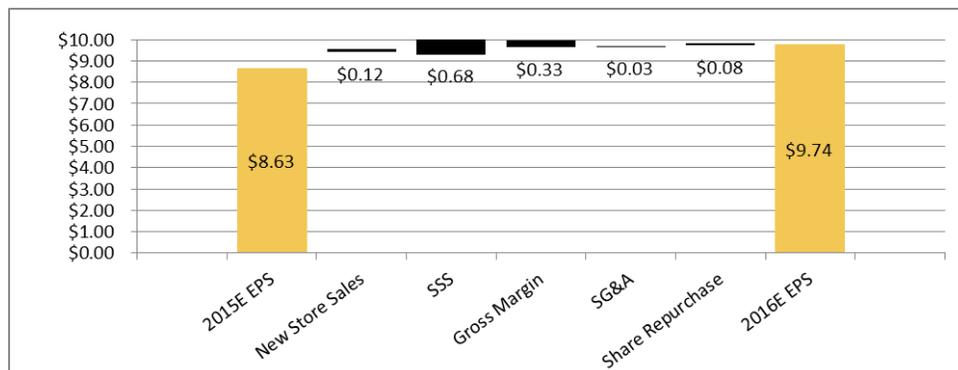
During 2015, I expect EPS to increase from \$7.46 to \$8.63. ORLY will be able to add \$1.17 in EPS through an increase in new store sales, a continuation of strong SSS, further improvement to their gross margin, a reduction in SG&A as a percent of sales, and additional share buybacks throughout 2015.

Figure 19: 2015 E EPS



205 planned net new stores and forecasted 6.8% SSS growth should boost EPS by \$0.70 in 2015. SSS should increase as a result of lower gas prices and the aging vehicle fleet. Furthermore, gross margin will continue to improve from 51.4% to 52.1% by year end and add another \$0.44 to EPS. This will mainly come as high profit margin generated by higher average ticket prices per customer due to increasing consumer spending levels. I am also modeling that SG&A will decrease slightly to 37.5% resulting in a \$0.02 increase to EPS. Finally, I am forecasting O'Reilly will continue to utilize its share buyback program adding an additional \$0.11 to EPS.

Figure 12: 2016 E EPS



I am modeling for a \$1.17 increase to EPS for 2015E and a \$1.11 for 2016E.

During 2016 I expect EPS to increase from \$8.63 to \$9.74. ORLY will be able to add \$1.11 in EPS through additional new store sales, an increase of SSS, further improvement to the gross margin from cost reduction, a decrease in SG&A as a percent of sales, and additional share buybacks throughout 2016. With 210 forecasted net new stores and projected 6.8% SSS growth, I am estimating a \$0.80 increase in EPS from new store sales and SSS in 2015. Furthermore, gross margin will continue to improve to 52.5% by year end adding another \$0.33 to EPS assuming consumer spending levels remain higher. I am also modeling that SG&A will decrease slightly to 37.0% resulting in a \$0.03 increase to EPS. Finally, I am forecasting O'Reilly will continue to utilize its share buyback program which will add an additional \$0.08 to EPS.

Figure 21 shows my quarterly and annual EPS expectations for 2015 and 2016. As you can see, my estimates are slightly more bullish than the consensus estimates.

**Figure 21: Estimated EPS versus consensus**

	FY 2014 A	Q1 2015 E	Q2 2015 E	Q3 2015 E	Q4 2015 E	FY 2015 E	Q1 2016 E	Q2 2016 E	Q3 2016 E	Q4 2016 E	FY 2016 E
My Estimates	\$ 7.46	\$ 2.06	\$ 2.28	\$ 2.41	\$ 2.01	\$ 8.63	\$ 2.18	\$ 2.57	\$ 2.72	\$ 2.27	\$ 9.74
Consensus	\$ 7.46	\$ 2.06	\$ 2.25	\$ 2.34	\$ 2.02	\$ 8.56	\$ 2.23	\$ 2.58	\$ 2.67	\$ 2.34	\$ 9.72
Sales (Mil.)	\$ 7,216					\$ 7,866					\$ 8,566

My Model has a slightly more bullish outlook on 2015E and 2016E EPS.

The reason my estimates are higher than consensus is I am factoring in share buybacks. O'Reilly has \$742 million remaining in its share buyback funds to be utilized. Management is expecting \$8.42 to \$8.52 in EPS for 2015 without factoring in any share buybacks. Also, I am bullish on consumer spending levels and lower gas prices for 2015 and 2016. More miles driven will result in the need for more parts, and consumer spending will lead to higher ticket prices thus generating a great profit margin for ORLY.

#### Bull/Bear Case

Despite being bullish on O'Reilly's outlook given its' promising business and industry drivers, as well as improving profitability, I am concerned with the impact the economy could have on its performance. The EPS I have forecasted in figure21 assumes a continuation of the current economic health. However, if the economy slows, O'Reilly sales will be as consumer spending falls. Figure 22 below shows how O'Reilly may be impacted during different economic conditions.

**Figure 22: Bull/Bear EPS Cases**

	2015 E			2016 E		
	Bear	Base	Bull	Bear	Base	Bull
Net Income	881,711	890,090	899,355	982,747	996,636	1,012,556
EPS	\$8.55	\$8.63	\$8.72	\$9.60	\$9.74	\$9.89

For 2015, the base case assumes a growing growth rate of sales of 9%. The bear and bull cases assume 8.5% and 9.5% respectively. For 2016, the base case assumes a sales growth rate of 8.9%, and the bear and bull are 8.4% and 9.5% respectively.

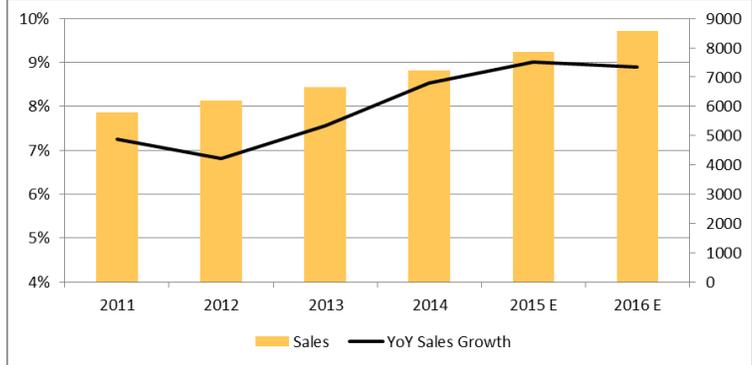
Revenues

Figure 23: 5 Year CAGR of Sales

Company	5 Year CAGR of Sales	
ORLY	O'REILLY AUTOMOTIVE	5.98%
AAP	Advanced Auto Parts	10.69%
LAD	LITHIA MOTORS	20.38%
GPC	GENUINE PARTS	6.63%
GPI	GROUP 1 AUTOMOTIVE	12.52%
PAG	PENSKE AUTOMOTIVE	9.90%
MNRO	MONRO MUFFLER BRAKE	8.05%
ABG	ASBURY AUTOMOTIVE	8.31%
KMX	CARMAX	10.98%
	Industry Average	10.38%

Source: Company reports

Figure 24: YoY Sales Growth and Total Sales



Source: Company reports

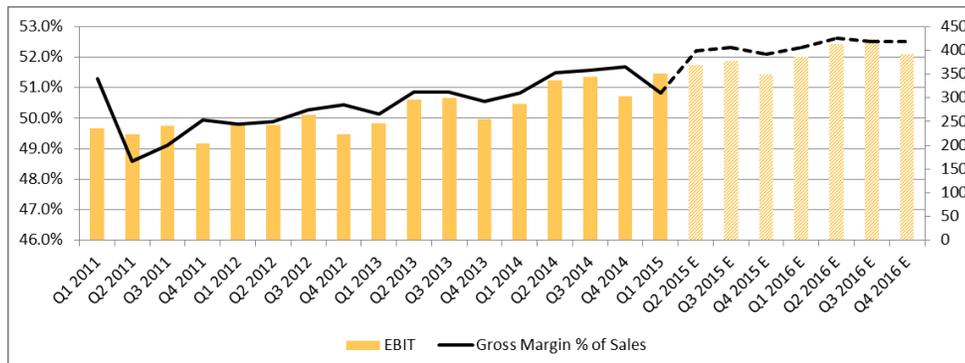
Since Q1 2012, O'Reilly has experienced a steady growth in its total revenue. As figure 24 shows, the sales growth rate YoY has also been steadily increasing, however, I am modeling for it to flatten out in the coming years as it will be difficult to maintain such a strong growth rate. In the base case, I expect O'Reilly's YoY sales growth to continue to remain positive, but at a decelerated rate through 2015 and 2016. I am modeling for sales to grow at 9% and 8.9% in 2015 and 2016 and for growth to continue to decelerate thereafter. New store growth will have less of an impact as the total number of stores increases to greater levels because it will be difficult to continue to open the same large percentage of new stores.

Year	2011	2012	2013	2014	2015 E	2016 E
Sales	\$5,788,816	\$6,182,184	\$6,649,237	\$7,216,081	\$7,865,528	\$8,565,560
Growth	7.25%	6.80%	7.55%	8.52%	9.00%	8.90%
# of Stores	3740	3976	4166	4366	4571	4781
Growth	4.8%	6.3%	4.8%	4.8%	4.7%	4.6%
SSS Growth	0.0%	4.0%	4.5%	6.3%	6.8%	6.8%

Operating Income and Margins

Margins have been improving boosting earnings to record levels. For 25 consecutive quarters ORLY has been able to boost EPS by 15% or more. The reduction in costs of goods sold (due to higher profit margins from higher ticket sales) has caused gross margin to become one of the key drivers for O'Reilly's earnings growth.

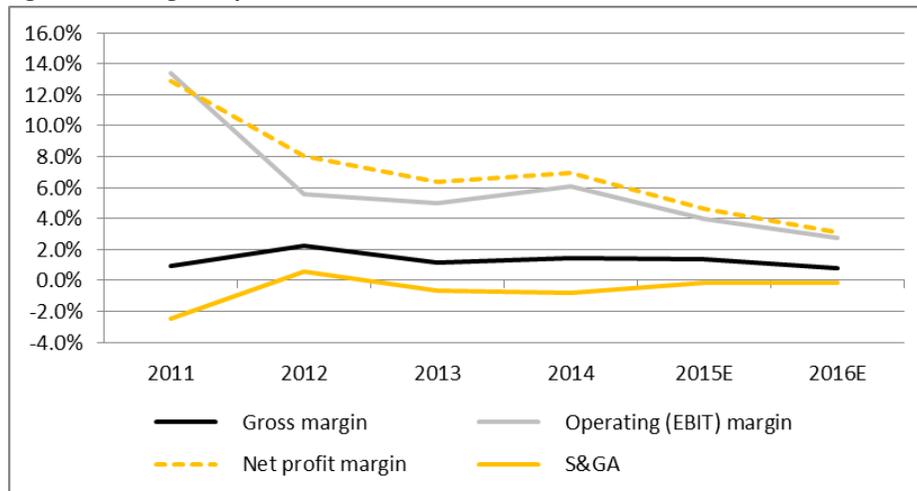
Figure 26: EBIT and Gross Margin



O'Reilly's margin improvement has led to greater earnings

I am modeling for the gross margin to continue to increase in 2015 and 2016 to 52.1% and 52.5% respectively. However, as it is unrealistic to expect COGS to fall indefinitely, I have the gross margin increasing at a decelerated pace for the next two years. O’Reilly’s operating margin has also improved due to gross margin growing at a faster pace than additional SG&A needs. For 2015 and 2016, I am forecasting ORLY to improve its’ operating margin to 18.4% and 18.8% respectively. Again, due to several years of increasing margin performance, I am expecting the increases to decelerate through 2015 and 2016. This idea of deceleration is supported by looking at the margin performance on a YoY basis in in figure 27 below.

Figure 27: Margin Improvement



Note that gross margin, operating margin, and net profit margin are all still growing but just at a slower rate. In addition, in every year except 2012, SG&A as a percent of sales decreased which shows the firm’s ability to grow sales without requiring similar additional SG&A.

The table below displays the current and five year averages of gross margins, operating margins, and net margins for O’Reilly and its publicly traded competitors. ORLY is the only company above its five-year averages in gross, operating, and net margins. Improvements in my gross margin will help ORLY increase its net margin from 10.8% to 11.3% during 2015. By January 2016, I am forecasting a net margin of 11.6%.

Figure 28: Competitor Margins

Company	Gross Margin		Operating Margin		Net Margin	
	Current	5 Year Avg	Current	5 Year Avg	Current	5 Year Avg
O'REILLY	51.4%	49.9%	17.6%	15.6%	10.8%	9.4%
LITHIA MOTORS	14.8%	15.8%	4.4%	4.2%	2.5%	2.0%
GENUINE PARTS	28.98	28.55	7.33	7.33	4.64	4.65
GROUP 1 AUTOMOTIVE	14.14	14.71	3.35	3.22	0.9	1.13
PENSKE AUTOMOTIVE	14.58	15.06	2.93	2.73	1.78	1.52
ADVANCE AUTO PARTS	45.24	48.99	9.75	10.33	5	5.9
MONRO MUFFLER BRAKE	38.48	39.55	11.47	11.65	6.55	6.68
ASBURY AUTOMOTIVE	16.03	16.05	4.88	4.05	1.91	1.53
CARMAX	12.42	12.93	4.27	4.19	4.19	4.09

Source: Factset

As a result of improved margins, NOPAT as a percent of sales has consistently increased for the last five years. It was 9.3% in 2011 and I expect it to be 12.0% in 2016E. ORLY has also seen a constant growth with its ROA, which has improved from 9.6% to 13.1% for the same five-year period.

#### Return on Equity

**Figure 29: ROE from 2011 to 2016E**

5-stage Dupont ROE	2011	2012	2013	2014	2015 E	2016 E
EBIT / sales	15.0%	15.8%	16.6%	17.6%	18.4%	18.8%
Sales / avg assets	1.10	1.10	1.13	1.14	1.15	1.12
EBT/EBIT	94.1%	96.3%	96.0%	96.2%	96.7%	97.0%
Net income (cont) /EBT	62.2%	62.2%	63.3%	63.7%	63.8%	63.8%
ROA	9.6%	10.4%	11.3%	12.3%	13.0%	13.1%
Avg assets / avg equity	1.74	2.27	2.90	3.16	3.09	2.79
ROE	16.8%	23.7%	32.9%	39.1%	40.0%	36.5%

ORLY has seen consistent growth on its ROE ratio due to increased profitability. ROA has also improved as asset turnover has been rising, again showing an improvement in efficiency. However, debt to assets and debt to equity have both climbed consistently from 2011 to 2014. O'Reilly has a stable business model, so the additional leverage is not necessarily alarming. This debt was used, in part, to buy back stock.

The firm is leveraged which could be boosting ROE

**Figure 30: ROE from 2011 to 2016E**

	2011	2012	2013	2014	2015E	2016E
Total Current Liabilities	1,426	2,086	2,221	2,623	2,871	3,126
% of assets	26%	36%	37%	40%	40%	39%
Long Term Debt	798	1,096	1,396	1,397	1,397	1,397
Other Liabilities	432	459	484	502	502	502
Total Liabilities	2,656	3,641	4,101	4,522	4,769	5,025
% of assets	48%	63%	68%	69%	66%	62%
Total Assets	5,501	5,749	6,067	6,540	7,197	8,061
ROE	17%	24%	33%	39%	40%	37%

#### Free Cash Flow

In 2014, O'Reilly realized FCFE of \$709 million; this is a decrease of about 10% from \$788 million in 2013; however, the reduction is due to raising less debt. Since 2010, ORLY has experienced relatively volatile FCF. While FCF has been up and down, FCFE has been on a downward trend since 2012. Again, this is primarily due to the firm taking in less debt in later years. Also, while NOPAT has steadily grown, net fixed assets have also grown at a great dollar rate.

For 2015 and 2016, I estimate a FCFE of \$480 and \$388 million respectively. The main reason for the drop is because I assume no new debt. NOPAT will rise and this is somewhat offset by higher growth in net fixed assets. Some of this excess cash can be used for a share repurchase program. On February 5, 2014, August 13, 2014, and February 4, 2015, ORLY approved an increase to the share repurchase program by an addition \$500 million. I expect ORLY to continue to repurchase shares during 2015 and 2016 utilizing some of the \$750 million in funds remaining.

Figure 31: FCF for 2011 to 2016E

Items	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16
<b>Free Cash Flow</b>						
NOPAT	\$539,407	\$608,063	\$698,487	\$808,867	\$920,841	\$1,027,388
<i>Growth</i>	24.4%	12.7%	14.9%	15.8%	13.8%	11.6%
NOWC	1,192,073	652,456	627,264	456,890	562,863	835,900
Net fixed assets	2,882,002	3,010,892	3,218,941	3,459,974	3,763,411	4,098,354
Total net operating capital	\$4,074,075	\$3,663,348	\$3,846,205	\$3,916,864	\$4,326,273	\$4,934,255
<i>Growth</i>	1.8%	-10.1%	5.0%	1.8%	10.5%	14.1%
- Change in NOWC	(82,031)	(539,617)	(25,192)	(170,374)	105,973	273,038
- Change in NFA	153,474	128,890	208,049	241,033	303,437	334,944
FCFF	\$467,964	\$1,018,790	\$515,630	\$738,208	\$511,432	\$419,406
<i>Growth</i>		117.7%	-49.4%	43.2%	-30.7%	-18.0%
- After-tax interest expense	31,734	22,317	28,195	30,685	30,751	30,751
+ Net new debt	438,870	298,382	300,252	432	-	-
FCFE	\$875,100	\$1,294,855	\$787,687	\$707,955	\$480,680	\$388,655
<i>Growth</i>		48.0%	-39.2%	-10.1%	-32.1%	-19.1%
Sources of cash (FCFE)	\$875,100	\$1,294,855	\$787,687	\$707,955	\$480,680	\$388,655
<b>Uses of cash</b>						
Other expense	\$0	\$0	\$0	\$0	\$0	\$0
Share buyback	875,477	478,595	(483,675)	(121,141)	233,193	188,655
Change in other equity	(2,970)	843,695	1,295,953	847,226	247,488	200,000
	\$872,507	\$1,322,290	\$812,278	\$726,085	\$480,681	\$388,655
Change in other liab	(2,593)	27,435	24,591	18,130	-	-
Total	\$875,100	\$1,294,855	\$787,687	\$707,955	\$480,681	\$388,655

In January 2011, O'Reilly's Board of Directors approved a share repurchase program. The program stated the company could repurchase stock from time to time without approval and could terminate the program at any time without prior notice. In total, the program authorized a total amount of \$5.0 billion. Each additional authorization is effective for 3 years.

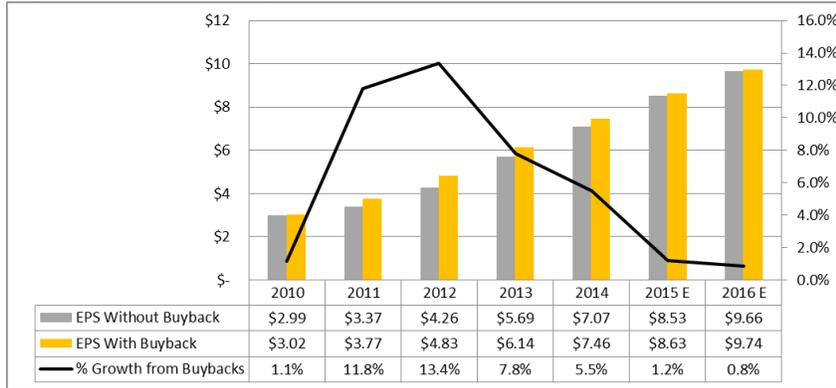
Through February 27, 2015, ORLY repurchased \$27.8 million in shares and had a remaining \$751.5 million remaining under its repurchase program. Below is a chart showing the impact of share buybacks on EPS for 2015E and 2016E.

Figure 32: Bull/Bear Repurchase Case

Repurchases and EPS			
2015	Bear	Base	Bull
# Shares Repurchased (Thousands)	1000	1250	2000
EPS	\$8.61	\$8.63	\$8.69
2016	Bear	Base	Bull
# Shares Repurchased (Thousands)	500	870	1000
EPS	\$9.70	\$9.74	\$9.75

Even though share buybacks have had a noticeable impact on EPS in the past, as the stock has become more expensive the effect on EPS has fallen. However, I still believe O'Reilly will use this share buyback program as a way of returning value to shareholders. ORLY has already utilized the program early in 2015 to repurchase 100,000 shares. Again, this will become a weaker driver in the future as it begins to have less of an impact on EPS. Below, in figure 33, the effect the share repurchase program has had on EPS is displayed.

Figure 33: Bull/Bear Repurchase Case



Source: IMCP

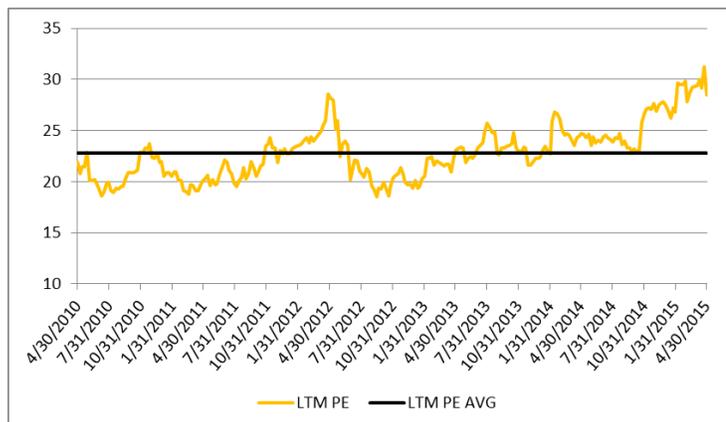
## Valuation

O’Reilly was valued using multiples and a 3-stage discounting cash flow model. Based on multiples, the stock is slightly expensive versus other firms; however, it has superior fundamentals and strong margin growth so the valuation appears justified. On a DCF basis, the stock is worth \$225, which is right in line with its current price of \$222.

### Trading History

Figure 34 shows ORLY shares have been trading above their five year average of 23x LTM P/E of for the past two years. This is probably due to their margin improvement, growing ROE, and the upward movement in the markets multiples. The above average LTM P/E shows a growing consumer willingness to put money into the market. Also, the increase to P/E comes as no surprise since ORLY has generated 25 consecutive quarters of EPS growth in excess of 15%.

Figure 34: LTM and LTM P/E Average



Source: Factset

ORLY is trading above its average P/E of 23 near 26

If ORLY maintains its current LTM P/E to the end of 2015, it should trade at \$246 by the end of the year. Discounting \$246 back to today at a 7.9% cost of equity, yields a price of \$229.66.

Figure 35: Bull/Bear Repurchase Case

	LTM P/E	Target	PV
Current	28.5	\$ 246	\$ 230
1 Year Average	26.2	\$ 226	\$ 211
2 Year Average	24.9	\$ 215	\$ 201
5 Year Average	22.8	\$ 197	\$ 184

Relative Valuation

O'Reilly is currently trading at a price to earnings multiple significantly higher than the average of its peers (TTM P/E of 28.5 vs 22.6). This reflects expectations of high growth (15.4 LTG vs 13.4 for the industry) as the company continues to improve margins, SSS, and earnings. A higher than historical average price to sales ratio reflects improving margins (discussed earlier). The firm has the highest P/S in the group, which is a little more than double the average (2.29 vs 1.02), but this is explained by its superior net margin (8.0% versus 4.3%).

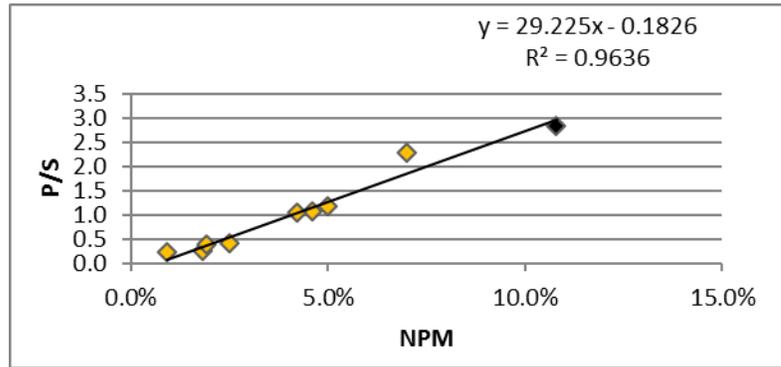
Figure 36: Competitor Composite

Ticker	Company Name	Current Price	Market Value	Price Change							Earnings Growth					Beta	LT Debt/Equity	S&P Rating	LTM Dividend		
				1 day	1 Mo	3 Mo	6 Mo	52 Wk	YTD	LTG	NTM	2014	2015E	2016E	Pst 5yr				Yield	Payout	
ORLY	O'REILLY AUTOMOTIVE INC	\$222.04	\$22,503	1.9	3.1	18.5	26.2	50.1	15.3	15.4	15.0%	36.9%	11.2%	12.9%	26.9%	0.79	65.2%	B+	0.00%	0.0%	
LAD	LITHIA MOTORS INC -CLA	\$102.52	\$2,691	2.8	5.7	21.0	32.1	35.2	18.3	19.0	10.8%	28.1%	20.0%	10.9%	66.6%		87.9%	B	0.64%	11.6%	
GPC	GENUINE PARTS CO	\$91.47	\$13,967	1.8	(0.3)	(1.6)	(5.8)	6.6	(14.2)	7.2	4.9%	10.0%	4.6%	8.3%	13.0%	0.95	15.7%	A	2.51%	51.3%	
GPI	GROUP 1 AUTOMOTIVE INC	\$80.86	\$1,963	2.4	(5.3)	0.6	(5.3)	10.6	(9.8)	12.3	82.2%	18.3%	14.8%	11.0%	19.2%		99.4%	B	0.85%	18.8%	
PAG	PENSKO AUTOMOTIVE GROUP INC	\$48.90	\$4,413	0.2	(3.8)	1.1	8.1	4.7	(0.3)	11.2	15.5%	18.5%	12.8%	9.8%	30.9%	1.33	81.7%	A+	0.16%	3.6%	
AAP	ADVANCE AUTO PARTS INC	\$145.34	\$10,630	1.6	1.1	(8.6)	(1.1)	20.1	(8.8)	13.1	27.1%	21.6%	15.6%	12.9%	18.8%	1.33	81.7%	A+	0.16%	3.6%	
MNRO	MONRO MUFFLER BRAKE INC	\$60.72	\$1,922	1.4	(5.9)	6.3	13.6	9.2	5.1		19.2%	13.2%	22.8%	19.0%	13.5%	1.07	179.6%	B	0.00%	0.0%	
ABG	ASBURY AUTOMOTIVE GROUP INC	\$84.97	\$2,315	1.1	3.3	14.5	21.3	36.1	11.9	13.5	40.6%	23.8%	18.5%	11.2%	45.5%	1.07	179.6%	B	0.00%	0.0%	
KMX	CARMAX INC	\$69.81	\$14,581	2.5	2.1	12.4	24.9	56.9	4.9	15.3	11.4%	17.8%	14.0%	13.6%		0.92	279.4%	B+	0.00%	0.0%	
Average				1.7	(0.0)	7.1	12.7	25.5	2.5	13.4	25.2%	20.9%	14.9%	12.2%	29.3%	1.07	118.9%		0.48%	9.9%	
Median				1.8	1.1	6.3	13.6	20.1	4.9	13.3	15.5%	18.5%	14.8%	11.2%	23.0%	1.07	87.9%		0.16%	3.6%	
SPX	S&P 500 INDEX	\$2,108		1.1	2.4	5.7	4.5	11.9	2.4		7.6%	1.6%	12.7%								
Ticker	Website	2016		P/E							2014			EV/		P/CF		Sales Growth			Book Equity
		ROE	P/B	2013	2014	2015E	TTM	NTM	2016E	NPM	P/S	OM	ROIC	EBIT	Current	5-yr	NTM	STM	Pst 5yr		
ORLY	<a href="http://www.oreillyauto.com">http://www.oreillyauto.com</a>	36.7%	10.50	39.2	28.6	25.7	28.5	24.8	22.8	10.8%	2.29	18.0%	23.0%	17.0	24.1	16.6	7.3%	6.1%	8.3%	\$21.15	
LAD	<a href="http://www.lithia.com">http://www.lithia.com</a>	19.9%	4.00	25.7	20.1	16.7	17.5	15.8	15.1	2.5%	0.50	4.3%	13.1%	17.0			28.9%	10.8%	25.2%	\$25.66	
GPC	<a href="http://www.genpt.com">http://www.genpt.com</a>	21.4%	4.24	21.8	19.8	19.0	19.7	18.8	17.5	4.6%	0.91	7.3%	18.6%	15.2	13.6	15.5	3.5%		8.8%	\$21.56	
GPI	<a href="http://www.group1auto.com">http://www.group1auto.com</a>	14.6%	2.01	16.3	13.8	12.0	21.0	11.5	10.8	0.9%	0.20	3.4%	4.8%	14.0	8.4	8.2	6.4%	8.4%	17.0%	\$40.18	
PAG	<a href="http://www.penskeautomotive.com">http://www.penskeautomotive.com</a>	17.9%	2.67	17.7	15.0	13.3	15.0	13.0	12.1	1.8%	0.26	3.0%	11.0%	16.9			9.2%	7.9%	12.5%	\$18.31	
AAP	<a href="http://www.advanceautoparts.com">http://www.advanceautoparts.com</a>	27.2%	5.30	23.7	19.5	16.8	21.7	17.0	14.9	5.0%	1.47	9.7%	15.9%	13.8	12.8	11.3	1.4%	3.6%	12.7%	\$27.41	
MNRO	<a href="http://www.monro.com">http://www.monro.com</a>	13.0%	4.19	36.4	32.1	26.2	32.7	27.4	22.0	7.0%	2.19	12.4%	9.4%	21.8	20.1	17.8	10.8%	13.0%	11.8%	\$14.49	
ABG	<a href="http://www.asburyauto.com">http://www.asburyauto.com</a>	31.5%	6.12	24.1	19.4	16.4	21.5	15.3	14.8	1.9%	0.38	4.9%	10.4%	13.4	12.0	8.6	8.2%	5.6%	10.0%	\$13.89	
KMX	<a href="http://www.carmax.com">http://www.carmax.com</a>	17.5%	4.62	31.0	26.3	23.1	25.6	23.0	20.4	4.2%	1.02	4.3%	5.3%	38.5	16.2		10.6%	10.6%	13.8%	\$15.11	
Average		22.2%	4.85	26.2	21.6	18.8	22.6	18.5	16.7	4.3%	1.02	7.5%	12.4%	18.6	15.3	13.0	9.6%	8.2%	13.4%		
Median		19.9%	4.24	24.1	19.8	16.8	21.5	17.0	15.1	4.2%	0.91	4.9%	11.0%	16.9	13.6	13.4	8.2%	8.2%	12.5%		
SPX	S&P 500 INDEX			19.4	18.0	17.7			15.7												

A more thorough analysis of P/S and NPM is shown in figure 37. The calculated R-squared indicates that 96% of the change in P/S is explained through NPM. In comparison to its peers, O'Reilly has the highest P/S and NPM, so it appears to be fairly valued versus the broad spectrum of peers. Assuming the relationship holds going forward, the fair value for ORLY is \$238 for the beginning of 2015.

- Estimated P/S = Estimated 2015 NPM (11.3%) \* 29.225 - .1826 = 3.11
- Target Price = Estimated P/S \* 2015 SPS (\$76.25) = \$237.89

Figure 37: P/S vs NPM for ORLY Comps



Source: Factset

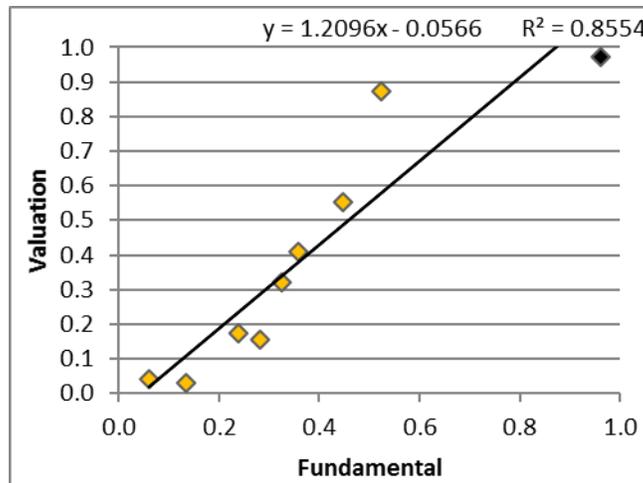
As final comparison, I also created a composite ranking of several valuation and fundamental metrics. The analysis is shown below. A weighted composite of percentiles of P/E, P/B, and P/S was compared to a weighted composite of percentiles for LTG, 2014 ROE and NPM. ORLY appears as the third most expensive stock according to this ranking; however, this is not too surprising as ORLY is one of the strongest stocks among its peers when looking at these metrics. However, since the stock is below the regression line, it appears it has more room to appreciate.

Figure 38: Composite Relative Valuation

Ticker	Name	Rank	Weight		Fundamental Rank			Valuation Rank		
			Fund	Value	12.5%	12.5%	75.0%	12.5%	75.0%	12.5%
					LTG	2014 ROE	2014 NPM	P/B	P/S	P/E TTM
ORLY	O'REILLY AUTOMOTIVE INC	9	96%	75%	70%	100%	100%	0%	100%	0%
LAD	LITHIA MOTORS INC -CL A	8	28%	26%	100%	29%	16%	65%	14%	54%
GPC	GENUINE PARTS CO	4	32%	42%	0%	35%	37%	69%	34%	60%
GPI	GROUP 1 AUTOMOTIVE INC	5	6%	12%	43%	7%	0%	33%	0%	64%
PAG	PENSKE AUTOMOTIVE GROUP INC	7	14%	13%	34%	20%	9%	44%	3%	46%
AAP	ADVANCE AUTO PARTS INC	2	45%	65%	50%	60%	41%	87%	61%	66%
MNRO	MONRO MUFFLER BRAKE INC	1	52%	93%	50%	0%	62%	68%	95%	100%
ABG	ASBURY AUTOMOTIVE GROUP INC	6	24%	27%	53%	78%	10%	100%	9%	66%
KMX	CARMAX INC	3	36%	49%	69%	19%	33%	76%	39%	78%

Source: FactSet

Figure 39: Composite Relative Valuation



Discounted Cash Flow Analysis

A three stage discounted cash flow model was also used to value O'Reilly.

For the purpose of this analysis, the company's cost of equity was calculated to be 7.86% using the Capital Asset Pricing Model. The underlying assumptions used in calculating this rate are as follows:

- The risk free rate, as represented by the ten year Treasury bond yield, is 2.10.
- An adjusted Beta of 0.9 was utilized to reflect ORLY as less risky than the market.
- A long term market rate of return of 8.5% was assumed which, despite the market historical return of 10%, is expecting a slowdown in coming years due to the superior outperformance of the market for the last 6 years.

Given the above assumptions, the cost of equity is 7.86% ( $2.10 + 0.90(8.5 - 2.10)$ ).

*Stage One* - The model's first stage simply discounts fiscal years 2015 and 2016 free cash flow to equity (FCFE). These per share cash flows are forecasted to be \$5.70 and \$6.46, respectively. Discounting these cash flows, using the cost of equity calculated above, results in a value of \$10.84 per share. Thus, stage one of this discounted cash flow analysis contributes \$10.84 to value.

*Stage Two* - Stage two of the model focuses on fiscal years 2017 to 2021. During this period, FCFE is assumed to grow at an annual rate of 11%. The resulting cash flows are then discounted using the company's 7.86% cost of equity.

**Figure 40: Discounted FCFE for ORLY**

	2015	2016	2017	2018	2019	2020	2021
FCFE	\$5.70	\$6.46	\$8.07	\$8.90	\$9.53	\$10.15	\$10.74
Discounted FCFE	\$5.29	\$5.55	\$6.43	\$6.57	\$6.53	\$6.45	\$6.33

*Stage Three* – For the terminal value of the company, you may recall, fiscal year 2015 and 2016 earnings per share are forecasted to be \$8.63 and \$9.74, respectively. It was then assumed that earnings per share would grow, from these forecasted numbers, at an average rate of 9.8% for the next five years (figure 41). I am assuming growth will slow as the firm continues to mature.

**Figure 41: EPS Estimates**

	2015	2016	2017	2018	2019	2020	2021
EPS	\$8.63	\$9.74	\$10.80	\$11.81	\$12.63	\$13.46	\$14.26
Growth	15.7%	12.9%	10.9%	9.3%	7.0%	6.5%	6.0%

Stage three of the model also requires an assumption regarding the company's terminal price-to-earnings ratio. For the purpose of this analysis, it is assumed that as the company grows larger and matures, its price-to-earnings ratio will converge near to the historical average of the S&P 500. Therefore, a price-to-earnings ratio of 21 is assumed at the end of O'Reilly's terminal year. While this may seem high at the end of 2021, O'Reilly has been trading at an average PE of over 21 for the last 5 years and is still experiencing solid growth. A lower multiple may be better to calculate fair value, but the stock will likely trade as this value since the market will be slow to price in ORLY's slowing growth.

Given the assumed terminal earnings per share of \$14.26 and a price to earnings ratio of 21, a terminal value of \$308.19 per share is calculated. Using the 7.86% cost of equity, this number can be discounted to a present value of \$181.47

**Total Present Value** – Given the above assumptions and utilizing a three stage discounted cash flow model, an intrinsic value of \$224.61 per share is calculated (\$10.84+\$32.31+\$181.47). Given O’Reilly’s current price of \$222, this model indicates that the stock is fairly valued.

**Figure 42: Terminal P/E Value Model**

<b>Cost of equity</b>		FCFE <sub>1</sub> (better def)	\$5.70	2015				
Risk free rate	2.10%	FCFE <sub>2</sub> (better def)	\$6.46	2016				
Beta	0.90							
Market return	8.5%	EPS <sub>1</sub>	\$8.63	2015				
Market risk prem	6.4%	EPS <sub>2</sub>	\$9.74	2016				
Stock risk premil	5.8%				<b>Terminal year P/E</b>			
	<b>7.9%</b>				2021	21.61		
<b>Cash flows</b>								
		2015	2016	2017	2018	2019	2020	2021
Sales		\$7,865,528	\$8,565,560	\$9,250,805	\$9,944,616	\$10,640,739	\$11,332,387	\$12,012,330
<i>Growth</i>			8.9%	8.0%	7.5%	7.0%	6.5%	6.0%
NOPAT		\$920,841	\$1,027,388	\$1,137,849	\$1,243,077	\$1,330,092	\$1,416,548	\$1,501,541
- Change in NWC		-1826	1070	13362	14231	15156	16141	17190
- Chg NFA		303437	334944	266393	283709	302150	321789	342706
FCFF		\$619,231	\$691,374	\$858,094	\$945,138	\$1,012,787	\$1,078,618	\$1,141,645
- Interest (1-tax rate)		30751	30751	32750	34879	37146	39560	42132
FCFE		\$588,479	\$660,623	\$825,344	\$910,259	\$975,641	\$1,039,058	\$1,099,514
<i>Growth</i>			12.3%	24.9%	10.3%	7.2%	6.5%	5.8%
/ No Shares		103152	102331	102331	102331	102331	102331	102331
<i>Growth</i>			-0.8%	0.0%	0.0%	0.0%	0.0%	0.0%
FCFE		\$5.70	\$6.46	\$8.07	\$8.90	\$9.53	\$10.15	\$10.74
* Discount factor		0.93	0.86	0.80	0.74	0.69	0.64	0.59
Discounted FCFE		\$5.29	\$5.55	\$6.43	\$6.57	\$6.53	\$6.45	\$6.33
EPS		\$5.40						
<b>Terminal value P/E</b>								
Net income		\$890,090	\$996,636	\$1,105,099	\$1,208,198	\$1,292,946	\$1,376,988	\$1,459,409
<i>% of sales</i>		11.3%	11.6%	11.9%	12.1%	12.2%	12.2%	12.1%
EPS		\$8.63	\$9.74	\$10.80	\$11.81	\$12.63	\$13.46	\$14.26
<i>Growth</i>			12.9%	10.9%	9.3%	7.0%	6.5%	6.0%
Terminal P/E								21.61
* Terminal EPS								\$14.26
Terminal value								\$308.19
* Discount factor								0.59
Discounted terminal value								<b>\$181.47</b>
<b>Value (P/E)</b>								
First stage	\$10.84	Present value of first 2 year cash flow						
Second stage	\$32.31	Present value of year 3-7 cash flow						
Third stage	\$181.47	Present value of terminal value P/E						
<b>Value (P/E)</b>	<b>\$224.61</b>	= value at beg of fiscal yr 2015						

Source: FactSet

**Sensitivity Analysis** –Since it could be argued that the assumed 11.0% second stage growth rate and/or the assumed terminal P/E ratio of 21 are overly conservative or aggressive, several scenarios were considered. For example, if the market return is adjusted to 10%, the new target price based on the price to earnings multiple would be \$208.

Also, variations in the given beta can have a large impact on the valuation. For example, a beta such as O’Reilly’s five year average beta of 0.55 gives a new valuation of \$262. However, the assigned beta of 0.9 seems more reasonable because it is line with the industry average and reflects that O’Reilly is less risky than the market.

## Business Risks

I believe that O'Reilly is currently trading at about fair value but the company will continue to improve and grow stock value; the following are risks to my bullish outlook on O'Reilly.

- 1) Deteriorating Economic Conditions
- 2) Competitive Market Place
- 3) Regional and National Weather
- 4) Reaching Business Efficiency
- 5) Decelerating Growth

### Deteriorating Economic Factors

O'Reilly benefits from an increase in consumer spending as a result of positive economic conditions. An increase in consumer spending leads to higher ticket sales. Consumers are willing to spend more, therefore; they are more willing to buy higher end parts which have a higher profit margin for ORLY. If the economy begins to slump, consumer may resort to purchasing cheaper products or none at all.

### Competitive Market Place

The automotive aftermarket business is highly competitive. In order for O'Reilly to remain competitive it must constantly employ new capital and resources to avoid losing presence in the market.

### Regional and National Weather

O'Reilly is subject to negative impacts due to unusual weather conditions or natural disasters. Long periods of harsh weather conditions deters customers from visiting stores for replacement parts. Long periods of harsh weather conditions could cause a temporary reduction in sales. However, extreme weather conditions can also drive excess need for replacement parts when weather improves.

### Reach Business Efficiency

For the last five years, ORLY has greatly improved profitability by reducing costs. However, at some point the room for margin improvement or cost reduction will reach an efficient frontier where further improvements are not possible.

### Decelerated Growth

O'Reilly has had 25 consecutive quarters of positive EPS growth of 15% or better. It is unrealistic to expect ORLY to be able to continue this trend for many years to come. SSS have also increased at an average rate of 5.5% over the last five years. It will be difficult for ORLY to maintain such a high SSS rate into the future.

Appendix 1: Comps

Ticker	Company Name	Current Price	Market Value	Price Change						Earnings Growth					Beta	LT Debt/ S&P		LTM Dividend			
				1 day	1 Mo	3 Mo	6 Mo	52 Wk	YTD	LTG	NTM	2014	2015E	2016E		Pst 5yr	Equity	Rating	Yield	Payout	
ORLY	O'REILLY AUTOMOTIVE INC	\$222.04	\$22,503	1.9	3.1	18.5	26.2	50.1	15.3	15.4	15.0%	36.9%	11.2%	12.9%	26.9%	0.79	65.2%	B+	0.00%	0.0%	
LAD	LITHIA MOTORS INC -CLA	\$102.52	\$2,691	2.8	5.7	21.0	32.1	35.2	18.3	19.0	10.8%	28.1%	20.0%	10.9%	66.6%		87.9%	B	0.64%	11.6%	
GPC	GENUINE PARTS CO	\$91.47	\$13,967	1.8	(0.3)	(1.6)	(5.8)	6.6	(14.2)	7.2	4.9%	10.0%	4.6%	8.3%	13.0%	0.95	15.7%	A	2.51%	51.3%	
GPI	GROUP 1 AUTOMOTIVE INC	\$80.86	\$1,963	2.4	(5.3)	0.6	(5.3)	10.6	(9.8)	12.3	82.2%	18.3%	14.8%	11.0%	19.2%		99.4%	B	0.85%	18.8%	
PAG	PENSKE AUTOMOTIVE GROUP INC	\$48.90	\$4,413	0.2	(3.8)	1.1	8.1	4.7	(0.3)	11.2	15.5%	18.5%	12.8%	9.8%	30.9%	1.33	81.7%	A+	0.16%	3.6%	
AAP	ADVANCE AUTO PARTS INC	\$145.34	\$10,630	1.6	1.1	(8.6)	(1.1)	20.1	(8.8)	13.1	27.1%	21.6%	15.6%	12.9%	18.8%	1.33	81.7%	A+	0.16%	3.6%	
MNRO	MONRO MUFFLER BRAKE INC	\$60.72	\$1,922	1.4	(5.9)	6.3	13.6	9.2	5.1		19.2%	13.2%	22.8%	19.0%	13.5%	1.07	179.6%	B	0.00%	0.0%	
ABG	ASBURY AUTOMOTIVE GROUP INC	\$84.97	\$2,315	1.1	3.3	14.5	21.3	36.1	11.9	13.5	40.6%	23.8%	18.5%	11.2%	45.5%	1.07	179.6%	B	0.00%	0.0%	
KMX	CARMAX INC	\$69.81	\$14,581	2.5	2.1	12.4	24.9	56.9	4.9	15.3	11.4%	17.8%	14.0%	13.6%		0.92	279.4%	B+	0.00%	0.0%	
Average				1.7	(0.0)	7.1	12.7	25.5	2.5	13.4	25.2%	20.9%	14.9%	12.2%	29.3%	1.07	118.9%		0.48%	9.9%	
Median				1.8	1.1	6.3	13.6	20.1	4.9	13.3	15.5%	18.5%	14.8%	11.2%	23.0%	1.07	87.9%		0.16%	3.6%	
SPX	S&P 500 INDEX	\$2,108		1.1	2.4	5.7	4.5	11.9	2.4		7.6%	1.6%	12.7%								
Ticker	Website	2016		P/E						2014			EV/		P/CF		Sales Growth			Book	
		ROE	P/B	2013	2014	2015E	TTM	NTM	2016E	NPM	P/S	OM	ROIC	EBIT	Current	5-yr	NTM	STM	Pst 5yr	Equity	
ORLY	<a href="http://www.oreillyauto.com">http://www.oreillyauto.com</a>	36.7%	10.50	39.2	28.6	25.7	28.5	24.8	22.8	10.8%	2.29	18.0%	23.0%	17.0	24.1	16.6	7.3%	6.1%	8.3%	\$21.15	
LAD	<a href="http://www.lithia.com">http://www.lithia.com</a>	19.9%	4.00	25.7	20.1	16.7	17.5	15.8	15.1	2.5%	0.50	4.3%	13.1%	17.0			28.9%	10.8%	25.2%	\$25.66	
GPC	<a href="http://www.genpt.com">http://www.genpt.com</a>	21.4%	4.24	21.8	19.8	19.0	19.7	18.8	17.5	4.6%	0.91	7.3%	18.6%	15.2	13.6	15.5	3.5%		8.8%	\$21.56	
GPI	<a href="http://www.group1auto.com">http://www.group1auto.com</a>	14.6%	2.01	16.3	13.8	12.0	21.0	11.5	10.8	0.9%	0.20	3.4%	4.8%	14.0	8.4	8.2	6.4%	8.4%	17.0%	\$40.18	
PAG	<a href="http://www.penskeautomotive.com">http://www.penskeautomotive.com</a>	17.9%	2.67	17.7	15.0	13.3	15.0	13.0	12.1	1.8%	0.26	3.0%	11.0%	16.9			9.2%	7.9%	12.5%	\$18.31	
AAP	<a href="http://www.advanceautoparts.com">http://www.advanceautoparts.com</a>	27.2%	5.30	23.7	19.5	16.8	21.7	17.0	14.9	5.0%	1.47	9.7%	15.9%	13.8	12.8	11.3	1.4%	3.6%	12.7%	\$27.41	
MNRO	<a href="http://www.monro.com">http://www.monro.com</a>	13.0%	4.19	36.4	32.1	26.2	32.7	27.4	22.0	7.0%	2.19	12.4%	9.4%	21.8	20.1	17.8	10.8%	13.0%	11.8%	\$14.49	
ABG	<a href="http://www.asburyauto.com">http://www.asburyauto.com</a>	31.5%	6.12	24.1	19.4	16.4	21.5	15.3	14.8	1.9%	0.38	4.9%	10.4%	13.4	12.0	8.6	8.2%	5.6%	10.0%	\$13.89	
KMX	<a href="http://www.carmax.com">http://www.carmax.com</a>	17.5%	4.62	31.0	26.3	23.1	25.6	23.0	20.4	4.2%	1.02	4.3%	5.3%	38.5	16.2		10.6%	10.6%	13.8%	\$15.11	
Average				22.2%	4.85	26.2	21.6	18.8	22.6	18.5	16.7	4.3%	1.02	7.5%	12.4%	18.6	15.3	13.0	9.6%	8.2%	13.4%
Median				19.9%	4.24	24.1	19.8	16.8	21.5	17.0	15.1	4.2%	0.91	4.9%	11.0%	16.9	13.6	13.4	8.2%	8.2%	12.5%
SPX	S&P 500 INDEX			19.4	18.0	17.7			15.7												

## Appendix 2: Consolidated Balance Sheet 2010-2016E

Balance Sheet	2010	2011	2012	2013	2014	2015 E	2016 E
Cash	\$ 29,721	\$ 361,552	\$ 248,128	\$ 231,318	\$ 250,560	\$ 358,359	\$ 630,327
Accounts receivable	183,652	203,753	181,174	198,123	213,211		
Inventory	2,023,488	1,985,748	2,276,331	2,375,047	2,554,789		
Prepaid expenses and other	33,877	-	-	-	-		
Future income tax benefits	-	-	-	-	-		
Notes Receivable, Less Current	18,047	10,889	5,347	13,066	13,349		
Other Current Assets	30,514	56,557	27,315	30,713	48,418		
Operating assets ex cash	2,289,578	2,256,947	2,490,167	2,616,949	2,829,767	3,075,422	3,332,003
Operating assets	2,319,299	2,618,499	2,738,295	2,848,267	3,080,327	3,433,780	3,962,330
Accounts payable	895,736	1,279,294	1,929,112	2,056,521	2,417,167		
Employee compensation payable							
Accrued liabilities	45,542	41,512	42,417	41,262	62,946		
Accrued payroll taxes and insurance	103,917	105,620	114,310	123,220	143,324		
Operating liabilities	1,045,195	1,426,426	2,085,839	2,221,003	2,623,437	2,870,918	3,126,430
NOWC	1,274,104	1,192,073	652,456	627,264	456,890	562,863	835,900
NOWC ex cash (NWC)	1,244,383	830,521	404,328	395,946	206,330	204,504	205,573
Goodwill	743,975	743,907	758,410	756,225	756,384		
Intangible assets							
PP&E	2,705,434	3,026,996	3,269,570	3,606,837	3,993,509		
Other assets, net	54,458	44,328	40,892	37,613	45,030		
FA, gross	3,503,867	3,815,231	4,068,872	4,400,675	4,794,923	5,208,959	5,672,556
Growth		8.9%	6.6%	8.2%	9.0%	8.6%	8.9%
Accum. D&A	(775,339)	(933,229)	(1,057,980)	(1,181,734)	(1,334,949)	(1,445,548)	(1,574,202)
D&A (adj for asset chg)		157,890	124,751	123,754	153,215	110,599	128,654
Life		23	32	34	30	45	42
Net intangible assets							
Net PP&E	1,930,095	2,093,767	2,211,590	2,425,103	2,658,560		
NFA	2,728,528	2,882,002	3,010,892	3,218,941	3,459,974	3,763,411	4,098,354
Growth		5.6%	4.5%	6.9%	7.5%	8.8%	8.9%
Invested capital	4,002,632	4,074,075	3,663,348	3,846,205	3,916,864	4,326,273	4,934,255
Marketable securities	-	-	-	-	-	-	-
<b>Total assets</b>	<b>\$ 5,047,827</b>	<b>\$ 5,500,501</b>	<b>\$ 5,749,187</b>	<b>\$ 6,067,208</b>	<b>\$ 6,540,301</b>	<b>\$ 7,197,191</b>	<b>\$ 8,060,684</b>
Debt	358,704	797,574	1,095,956	1,396,208	1,396,640	1,396,640	1,396,640
Other liabilities	434,243	431,650	459,085	483,676	501,806	501,806	501,806
Debt/equity securities	-	-	-	-	-	-	-
Equity							
Common stock	1,143,159	1,244,314	1,234,374	1,205,790	1,260,387	1,289,694	1,301,039
Retained earnings	2,069,496	2,577,169	2,319,220	1,693,559	1,624,515	2,267,117	3,063,754
Other	(2,970)	-	-	-	-	-	-
Net	3,209,685	3,821,483	3,553,594	2,899,349	2,884,902	3,556,811	4,364,793
Treasury stock	-	976,632	1,445,287	933,028	866,484	1,128,984	1,328,984
Total	3,209,685	2,844,851	2,108,307	1,966,321	2,018,418	2,427,827	3,035,809
Total supplied capital	4,002,632	4,074,075	3,663,348	3,846,205	3,916,864	4,326,273	4,934,255
<b>Total liabilities and equity</b>	<b>\$ 5,047,827</b>	<b>\$ 5,500,501</b>	<b>\$ 5,749,187</b>	<b>\$ 6,067,208</b>	<b>\$ 6,540,301</b>	<b>\$ 7,197,191</b>	<b>\$ 8,060,684</b>

## Appendix 3: Income Statement 2010-2016E

Income Statement	2010	2011	2012	2013	2014	2015 E	2016 E
Sales	\$ 5,397,525	\$ 5,788,816	\$ 6,182,184	\$ 6,649,237	\$ 7,216,081	\$ 7,865,528	\$ 8,565,560
Growth		7.2%	6.8%	7.6%	8.5%	9.0%	8.9%
Direct Costs	2,776,533	2,951,467	3,084,766	3,280,236	3,507,180	3,767,588	4,068,641
Gross Margin	2,620,992	2,837,349	3,097,418	3,369,001	3,708,901	4,097,940	4,496,919
SG&A	1,887,316	1,973,381	2,120,025	2,265,516	2,438,527	2,654,616	2,886,594
Other	20,900	(2,798)					-
EBIT	712,776	866,766	977,393	1,103,485	1,270,374	1,443,324	1,610,325
Growth		21.6%	12.8%	12.9%	15.1%	13.6%	11.6%
Interest (total other expense)	23,403	50,993	35,872	44,543	48,192	48,199	48,199
EBT	689,373	815,773	941,521	1,058,942	1,222,182	1,395,125	1,562,126
Taxes	270,000	308,100	355,775	388,650	444,000	505,035	565,490
Continuing income	419,373	507,673	585,746	670,292	778,182	890,090	996,636
Other	-	-	-	-	-	-	-
Net income	419,373	507,673	585,746	670,292	778,182	890,090	996,636
Growth		21.1%	15.4%	14.4%	16.1%	14.4%	12.0%
Basic Shares	138,654	134,667	121,182	109,244	104,262	103,152	102,331
EPS	3.02	3.77	4.83	6.14	7.46	8.63	9.74
Growth		24.6%	28.2%	26.9%	21.6%	15.6%	12.9%

## Appendix 4: Sales 2010-2016E

Sales	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16
Sales	5,397,525	5,788,816	6,182,184	6,649,237	7,216,081	7,865,528	8,565,560
Growth		7.2%	6.8%	7.6%	8.5%	9.0%	8.9%
Stores BOY	3421	3570	3740	3976	4166	4366	4,571
Openings	156	183	236	195	207	210	217
Closures	(7)	(13)	0	(5)	(7)	(5)	(7)
Total Stores EOY	3570	3740	3976	4166	4366	4571	4,781
Growth		4.8%	6.3%	4.8%	4.8%	4.7%	4.6%
Total sales	5,397,525	5,788,816	6,182,184	6,649,237	7,216,081	7,865,528	8,565,560
Sales Per Store	1512	1,599.03	1,626.15	1,639	1,711	1780	1852
Growth		5.8%	1.7%	0.8%	4.4%	4.0%	4.0%
New Comparable Store Sales		311,000	293,000	333,000	479,000	554,905	598,342
Total comparable store sales		5,708,525	6,081,816	6,515,184	7,128,237	7,770,986	8,463,869.59
New store sales		80,291	100,368	134,053	87,844	94,542	101,690
Sales Per Store		945	851	1,411	878	922	968
Growth			-10.0%	65.9%	-37.7%	5.0%	5.0%
Increase comp store sales (opened at least one year)		241,000	215,000	259,000	389,000	454,905	488,342
Increase comp store sales (opened last year)		70,000	78,000	74,000	90,000	100,000	110,000
Comparable store sales (opened at least one year)		6,029,816	5,612,525	6,047,816	6,571,184	7,104,142	7,704,423
Comparable stores (opened at least one year)			3570	3740	3976	4166	4366
Growth				4.8%	6.3%	4.8%	4.8%
Sales Per Store			1,572.14	1,617.06	1,653	1,705	1,765
Growth(annual)				2.9%	2.2%	3.2%	3.5%
Growth in SSS			3.98%	4.47%	6.29%	6.84%	6.77%

## Appendix 5: Cash Flow 2010-2016E

<b>Cash Flow Statement</b>						
<b>Note: This is not the actual cash flow statement. It is created using the indirect method and various simplifying assumptions.</b>						
<b>Items</b>	<b>Dec-11</b>	<b>Dec-12</b>	<b>Dec-13</b>	<b>Dec-14</b>	<b>Dec-15</b>	<b>Dec-16</b>
<b>Cash from Operatings (understated - depr'n added to net assets)</b>						
Net income	\$507,673	\$585,746	\$670,292	\$778,182	\$890,090	\$996,636
Change in Net Working Capital ex cash	413,862	426,193	8,382	189,616	1,826	(1,070)
Cash from operations	921,535	1,011,939	678,674	967,798	891,916	995,567
<b>Cash from Investing (understated - depr'n added to net assets)</b>						
Change in Net PP&E	(153,474)	(128,890)	(208,049)	(241,033)	(303,437)	(334,944)
Change in Marketable Securities	-	-	-	-	-	-
Cash from investing	(153,474)	(128,890)	(208,049)	(241,033)	(303,437)	(334,944)
<b>Cash from Financing</b>						
Change in Debt	438,870	298,382	300,252	432	-	-
Change in Other liabilities	(2,593)	27,435	24,591	18,130	-	-
Change in Par and Paid in Capital	101,155	(9,940)	(28,584)	54,597	29,307	11,345
Change in Other Equity	2,970	-	-	-	-	-
Share Buyback	(976,632)	(468,655)	512,259	66,544	(262,500)	(200,000)
Change in RE ex NI and Dividends	-	(843,695)	(1,295,953)	(847,226)	(247,488)	(200,000)
Cash from financing	(436,230)	(996,473)	(487,435)	(707,523)	(480,681)	(388,655)
<b>Change in Cash</b>	<b>331,831</b>	<b>(113,424)</b>	<b>(16,810)</b>	<b>19,242</b>	<b>107,799</b>	<b>271,968</b>
<b>Beginning Cash</b>	<b>29,721</b>	<b>361,552</b>	<b>248,128</b>	<b>231,318</b>	<b>250,560</b>	<b>358,359</b>
<b>Ending Cash</b>	<b>361,552</b>	<b>248,128</b>	<b>231,318</b>	<b>250,560</b>	<b>358,359</b>	<b>630,327</b>

## Appendix 6: Ratios 2010 to 2016E

Ratios	2010	2011	2012	2013	2014	2015 E	2016 E
<b>Profitability</b>							
Gross margin	48.6%	49.0%	50.1%	50.7%	51.4%	52.1%	52.5%
Operating (EBIT) margin	13.2%	15.0%	15.8%	16.6%	17.6%	18.4%	18.8%
Net profit margin	7.8%	8.8%	9.5%	10.1%	10.8%	11.3%	11.6%
<b>Activity</b>							
FA (gross) turnover		1.58	1.57	1.57	1.57	1.57	1.57
Total asset turnover		1.10	1.10	1.13	1.14	1.15	1.12
Inventory Turnover		1.47	1.45	1.41	1.42		
Inventory processing period		247.91	252.15	258.79	256.53		
Accounts Receivables Turnover		29.89	32.12	35.06	35.09		
Receivables collection period		12.21	11.36	10.41	10.40		
Operating Cycle		260.12	263.52	269.20	266.93		
Accounts Payables Turnover		2.71	1.92	1.65	1.57		
Payable payment period		134.49	189.81	221.75	232.79		
Cash Conversion Cycle		125.63	73.70	47.45	34.14		
<b>Liquidity</b>							
Op asset / op liab	2.22	1.84	1.31	1.28	1.17	1.20	1.27
NOWC Percent of sales		21.3%	14.9%	9.6%	7.5%	6.5%	8.2%
<b>Solvency</b>							
Debt to assets	7.1%	14.5%	19.1%	23.0%	21.4%	19.4%	17.3%
Debt to equity	11.2%	28.0%	52.0%	71.0%	69.2%	57.5%	46.0%
Other liab to assets	8.6%	7.8%	8.0%	8.0%	7.7%	7.0%	6.2%
Total debt to assets	15.7%	22.3%	27.0%	31.0%	29.0%	26.4%	23.6%
Total liabilities to assets	36.4%	48.3%	63.3%	67.6%	69.1%	66.3%	62.3%
Debt to EBIT	0.50	0.92	1.12	1.27	1.10	0.97	0.87
EBIT/interest	30.46	17.00	27.25	24.77	26.36	29.94	33.41
<b>ROIC</b>							
NOPAT to sales		9.3%	9.8%	10.5%	11.2%	11.7%	12.0%
Sales to IC		1.43	1.60	1.77	1.86	1.91	1.85
Total		13.4%	15.7%	18.6%	20.8%	22.3%	22.2%
Total using EOY IC	10.8%	13.2%	16.6%	18.2%	20.7%	21.3%	20.8%
<b>ROE</b>							
<b>5-stage</b>							
EBIT / sales		15.0%	15.8%	16.6%	17.6%	18.4%	18.8%
Sales / avg assets		1.10	1.10	1.13	1.14	1.15	1.12
EBT/EBIT		94.1%	96.3%	96.0%	96.2%	96.7%	97.0%
Net income (cont) /EBT		62.2%	62.2%	63.3%	63.7%	63.8%	63.8%
ROA		9.6%	10.4%	11.3%	12.3%	13.0%	13.1%
Avg assets / avg equity		1.74	2.27	2.90	3.16	3.09	2.79
ROE		16.8%	23.7%	32.9%	39.1%	40.0%	36.5%
<b>3-stage</b>							
Net income (cont) / sales		8.8%	9.5%	10.1%	10.8%	11.3%	11.6%
Sales / avg assets		1.10	1.10	1.13	1.14	1.15	1.12
ROA		9.6%	10.4%	11.3%	12.3%	13.0%	13.1%
Avg assets / avg equity		1.74	2.27	2.90	3.16	3.09	2.79
ROE		16.8%	23.7%	32.9%	39.1%	40.0%	36.5%
ROE using EOY equity		17.8%	27.8%	34.1%	38.6%	36.7%	32.8%

Appendix 7: SWOT Analysis



Appendix 8: Porters Five Forces

<b>Intensity of Competition</b>	<ul style="list-style-type: none"> <li>• <b>High</b></li> <li>• The automotive parts industry is highly competitive often leading to difficulty in pricing flexibility</li> </ul>
<b>Threat of New Entrants</b>	<ul style="list-style-type: none"> <li>• <b>Moderate</b></li> <li>• Competition is intense; however ORLY does not stand much of a threat from new entrants</li> </ul>
<b>Bargaining Power of Buyers</b>	<ul style="list-style-type: none"> <li>• <b>Low</b></li> <li>• O'Reilly's customers can shop around for parts but don't have much leverage on pricing power</li> </ul>
<b>Bargaining Power of Suppliers</b>	<ul style="list-style-type: none"> <li>• <b>Moderate/Low</b></li> <li>• Many of O'Reilly's suppliers also supply other auto parts stores so the pricing is competitive</li> </ul>
<b>Threat of Substitute Products</b>	<ul style="list-style-type: none"> <li>• <b>High</b></li> <li>• There are many options of places to shop for auto parts so O'Reilly doesn't have much of an advantage with their products over competitors</li> </ul>