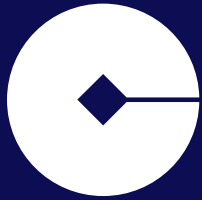




**MOI  
GLOBAL**

*The Membership  
Community of  
Intelligent Investors*



CENTERSTONE  
INVESTORS

PRESENTATION OF:  
O'REILLY AUTO PARTS



January 2018



Hosted by MOI Global

# CENTERSTONE INVESTORS

## New Firm, Old Roots

### PURPOSE

- ◆ Founded in 2016 by highly regarded Global Value investor, Abhay Deshpande
- ◆ Launched to provide our clients with a nimble and flexible, value-oriented investment approach with a focus on downside protection while seeking to participate in upside returns
- ◆ New York-based, privately owned SEC-registered investment advisor offering niche investment vehicles
- ◆ Established as a 100% founder and employee owned firm, creating alignment with our investors

### BACK TO OUR ORIGINS

- ◆ Broad and flexible mandates
- ◆ Seek to take advantage of all opportunities in the marketplace without investment limitations on geographies, industries, market capitalizations and capital structure
- ◆ Heavily focused on the fundamental analysis of businesses

### EXPERIENCED TEAM, PROVEN TRACK RECORD

- ◆ The strategies are a natural extension of our expertise
- ◆ All Managing Partners previously worked together for over a decade



## CENTERSTONE'S DISTINCT INVESTMENT APPROACH

Successful investing requires a strong dose of common sense. As a result, we approach security analysis from a different perspective. We are business analysts, not “equity” analysts. Business analysis is a more holistic approach which includes the entirety of a firm’s capital structure and allows us, in our opinion, to more accurately gauge the prospects for impairment in business value.

*“Successful investing requires a strong dose of common sense. As a result, we approach security analysis from a different perspective. We are business analysts, not ‘equity’ analysts.”*

As the name of the firm states, we are *investors*, which implies a long-term time horizon. Since most peers operate on an annual cycle, they attempt to maximize short-term gains. Being privately owned with an employee ownership culture allows us, in our opinion, to more effectively align our interests with our investors.

We define risk simply as the chance for permanent loss of capital. Our distinct investment approach seeks to minimize losses at a portfolio level by trying to have adequate diversification of risks. We will default to cash and high quality bonds in the absence of qualifying investments. It is our belief that our risk management techniques on a security-level and portfolio-level attempt to address the risk most commonly defined by shareholders: volatility.

There is no guarantee that any investment will achieve its objectives. No amount of diversification can ensure profits or prevent losses.



## CENTERSTONE'S GUIDELINES TO INTELLIGENT INVESTING

A long-term time horizon and the avoidance of permanent capital loss are the keys to a successful investment strategy



Business quality, balance sheet quality, and management quality are as important as price in considering the difference between an investment and a speculation

The flexibility to hold reserves is an important tool in the event that the bottom-up search yields few opportunities

**VALUE INVESTING OFTEN OPERATES  
IN THE “GREY AREA” WHERE  
POTENTIAL OPPORTUNITY &  
POTENTIAL IMPAIRMENT RISK ARE  
MORE TIGHTLY BOUND THAN USUAL**



### COMPANY DESCRIPTION

- ◆ Founded in 1957 by O'Reilly family & headquartered in Springfield, Missouri
- ◆ Leading aftermarket auto parts retailer in US
- ◆ Auto aftermarket industry includes all products & services purchased for light & heavy duty vehicles after original sale

### LONG-TERM SHARE PRICE PERFORMANCE



Source: Bloomberg

Public Market Overview				
<i>In thousands, except per share amounts</i>				
Share price (12/29/2017)	\$240.54			
Fully diluted share count (thousands)	85,028			
<b>Market Capitalization</b>	<b>\$20,452,562</b>			
Plus: Long-Term Debt	2,900,816			
Minus: Cash and Cash Equivalents	(37,287)			
Minus: Marketable Securities	(24,528)			
<b>Enterprise Value</b>	<b>\$23,291,563</b>			
Key Financial Metrics				
	FY 2014	FY 2015	FY 2016	LTM <sup>1</sup>
Revenue	7,216,081	7,966,674	8,593,096	8,886,220
Gross Profit	3,708,901	4,162,643	4,509,011	4,675,730
% margin	51.4%	52.3%	52.5%	52.6%
EBITDA	1,464,579	1,724,277	1,917,072	1,960,194
% margin	20.3%	21.6%	22.3%	22.1%
EBIT	1,270,374	1,514,021	1,699,206	1,730,275
% margin	17.6%	19.0%	19.8%	19.5%
Economic EBIT	1,311,374	1,542,086	1,748,211	1,752,275
% margin	18.2%	19.4%	20.3%	19.7%
Diluted EPS	7.34	9.17	10.73	11.74
LTM Trading Multiples & Leverage				
TEV / Revenue	2.62x	Net Debt / EBITDA		1.5
TEV / EBITDA	11.9	EBITDA / Interest		23.5
TEV / EBIT	13.5			

<sup>1</sup>LTM as of 9/30/2017

Source: O'Reilly company filings

## INDUSTRIES SERVED

Core business - vehicles 6 years+



### DO-IT-YOURSELF (DIY)

- ◆ Customers primarily purchase auto parts from O'Reilly stores
- ◆ Approximately 5,000 stores
- ◆ Trained staff helps customers select correct parts for vehicle



### CUSTOMER MIX



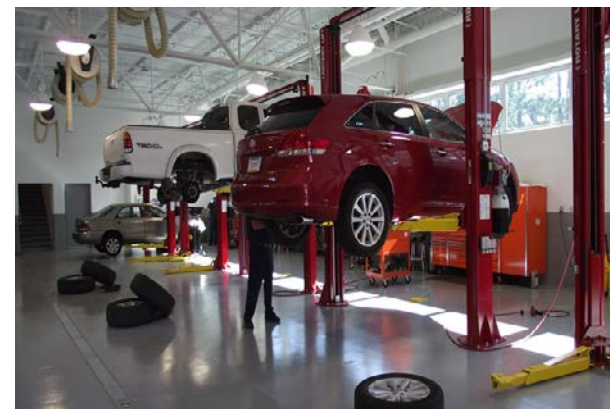
■ Do-It-Yourself (DIY): 58%

■ Do-It-For-Me (DIFM): 42%

Source: O'Reilly company filings

### DO-IT-FOR-ME (DIFM)

- ◆ Customers primarily have auto parts shipped to their place of business
- ◆ Ships auto parts from stores directly to customers
- ◆ Helps mechanics in automobile repair shop fix customers' vehicles faster

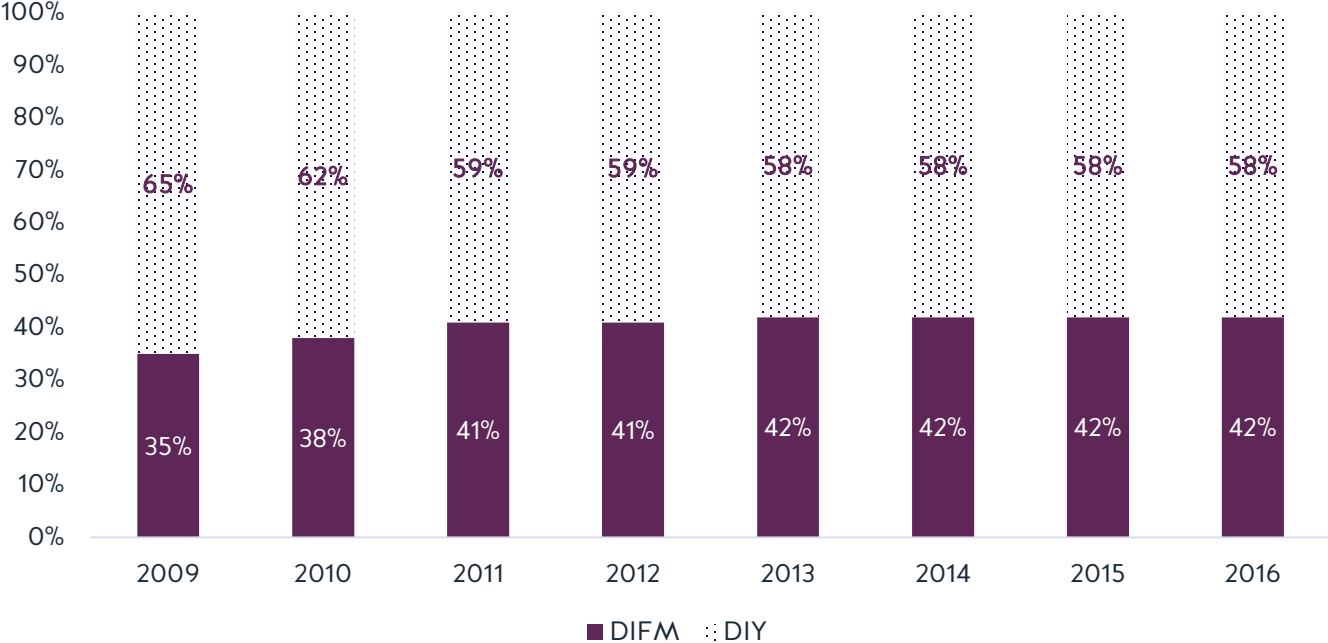


# BALANCED MIX OF CUSTOMERS SERVED



- ◆ Operates a dual market strategy – sells auto parts to DIY & DIFM customers
- ◆ Historically derived approximately 50% of sales from both DIY & DIFM
- ◆ Acquisition in 2008 altered mix

## REVENUES BY CUSTOMER TYPE



Source: O'Reilly company filings



# BREADTH OF PRODUCTS



## PROPRIETARY



## NATIONAL



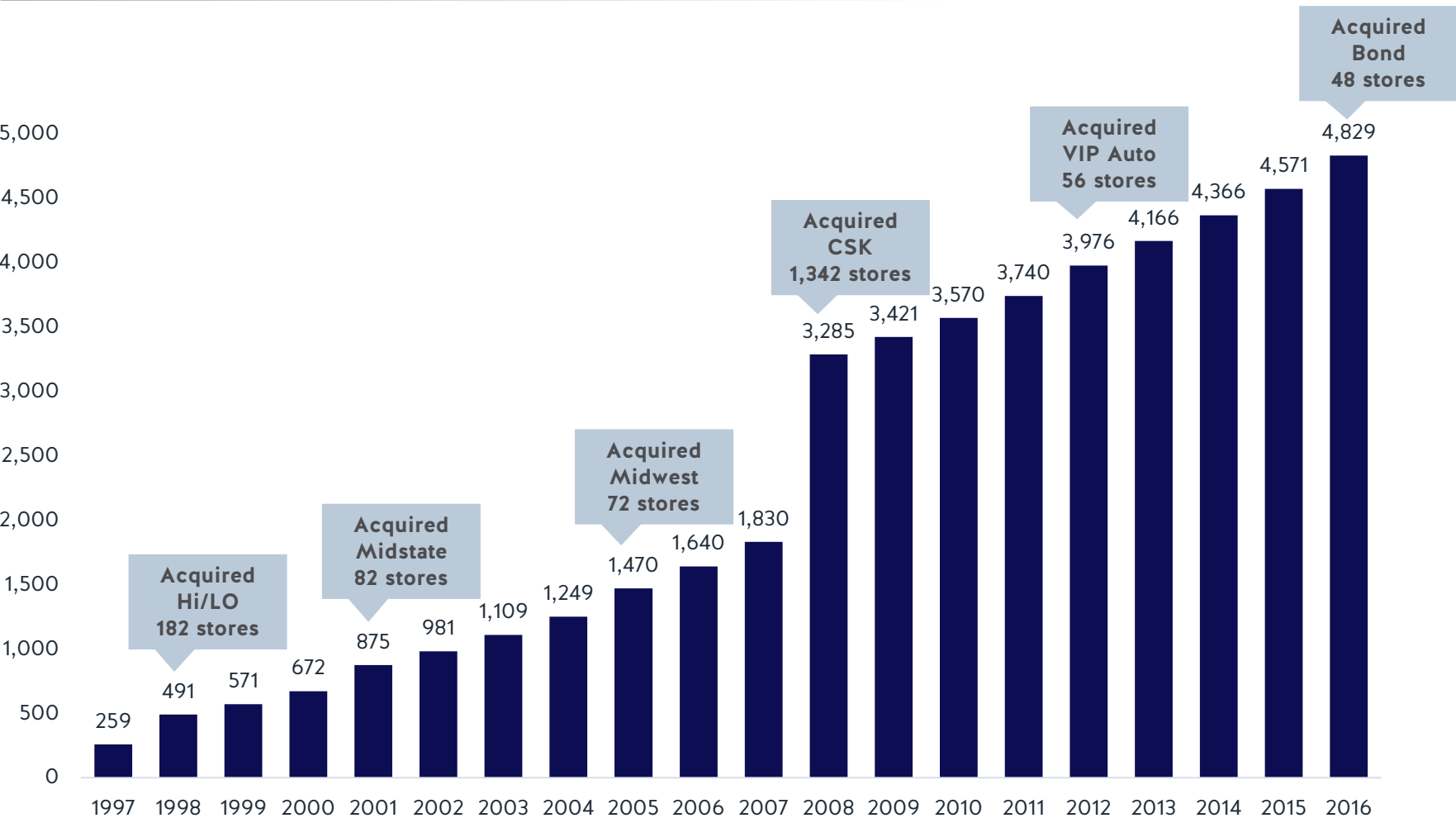
Source: O'Reilly company presentation



# ORGANIC GROWTH COUPLED WITH M&A



## NUMBER OF O'REILLY STORES



Source: O'Reilly company filings



# GEOGRAPHIC FOOTPRINT



- ◆ Largest markets are Texas & California (~25% total store count)
- ◆ Continued to grow store base in Texas, California & other states
- ◆ Opening stores in new markets for decades
- ◆ Presence in most of US through organic growth & acquisitions (limited presence in Northeast)

## STORES BY REGION

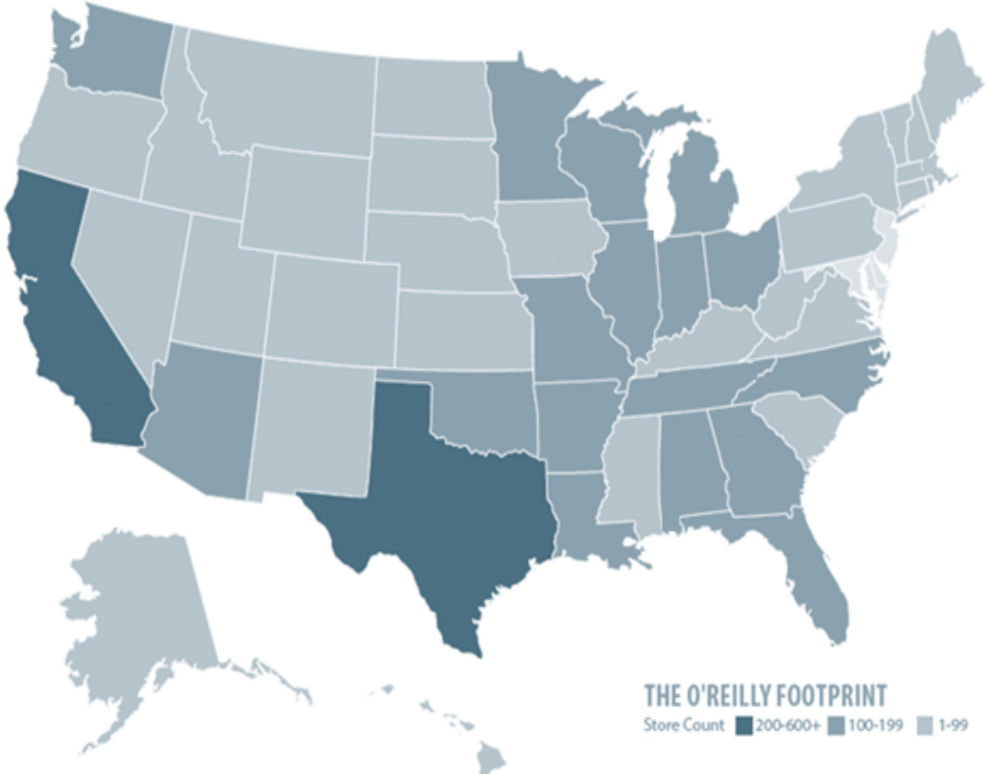


■ Northeast: 3% ■ Midwest: 27%  
 ■ South: 44% ■ West: 26%

Source: O'Reilly company filings



## STORES BY STATE



Source: O'Reilly company filings

## LARGEST PLAYERS



- ◆ One of biggest auto parts chains in US
- ◆ 3 large auto parts chains in US: AutoZone, Advance Auto Parts & O'Reilly Auto Parts
- ◆ 3 largest players combined make up over 40% of overall auto parts industry stores

### TOP 10 AUTO PARTS CHAINS

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1. AutoZone Inc. (5,381)<sup>1</sup>
2. Advance Auto Parts (5,189)<sup>2</sup>
3. O'Reilly Auto Parts (4,934)
4. Genuine Parts/NAPA (1,368)<sup>2</sup>
5. Pep Boys/Auto Plus (1,069)<sup>2</sup>
6. Fisher Auto Parts (500)<sup>2</sup>
7. Auto-Wares (172)<sup>2</sup>
8. Replacement Parts (170)
9. Automotive Parts Headquarters (121)
10. Hahn Automotive (89)

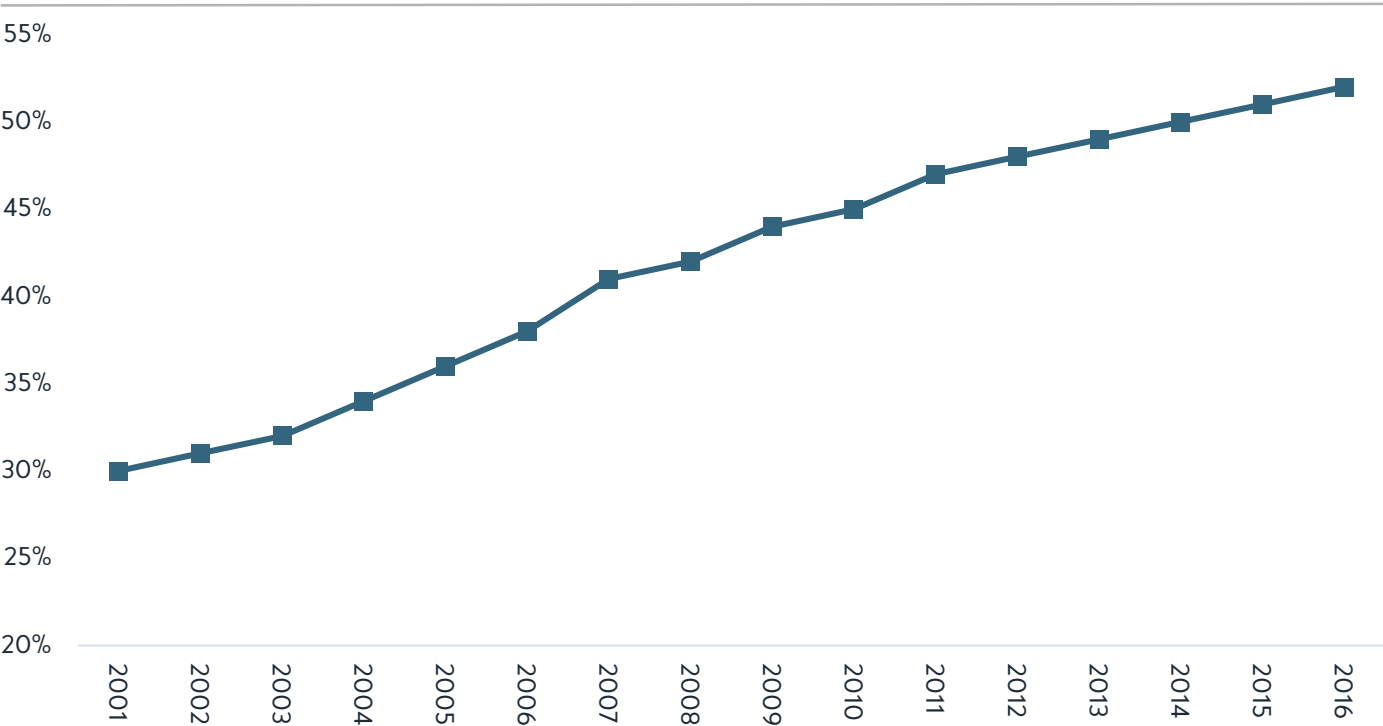
Source: 2018 ACA Factbook

# LARGEST PLAYERS CONSOLIDATING THE INDUSTRY



- ◆ 2001-2016 number of total auto parts retail locations in US remained ~36,000
- ◆ Industry has been consolidating & top auto parts chains gaining share over time
- ◆ Market remains relatively fragmented

## TOP 10 AUTO PARTS STORES SHARE OF TOTAL INDUSTRY STORES



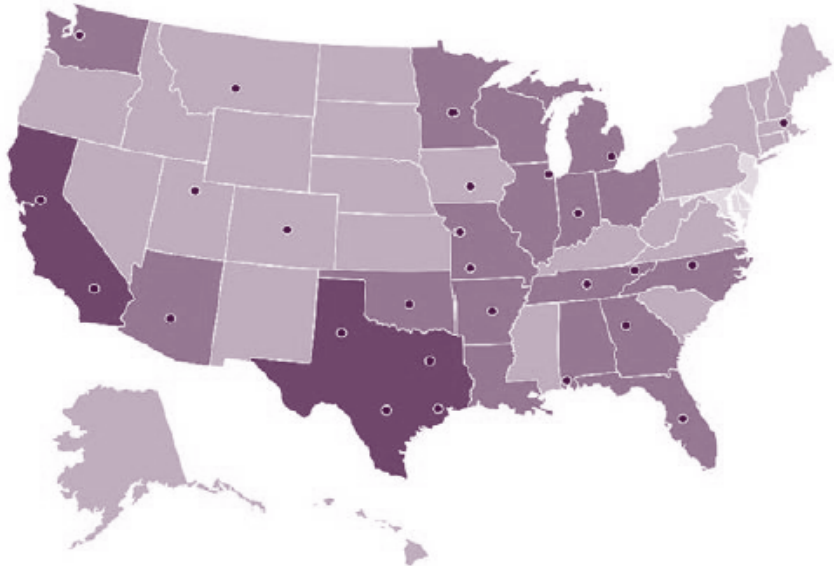
Source: 2018 ACA Factbook



**DISTRIBUTION CENTERS & HUB STORES**

- ◆ Regional, tiered distribution network – expanded over time as business grew
- ◆ Distribution network currently includes 27 regional distribution centers – average 148,000 stock keeping units (SKUs)
- ◆ Distribution centers augmented by 312 hub stores – average 45,000 SKUs
- ◆ Stores within close proximity to regional distribution centers & hub stores
- ◆ >90% of stores receive multiple deliveries a day from either distribution centers or local hub store
- ◆ **Same-day access provides industry leading parts availability & store in-stock levels**

**DISTRIBUTION CENTER LOCATIONS**



Source: O'Reilly company presentation

**DISTRIBUTION CENTER**



**THIS “GREY AREA” BETWEEN  
EXTREMES IS WHERE WE OFTEN  
FIND VALUES**

# DIY CUSTOMERS VALUE ADD



- ◆ DIY customers may have never done a repair or its been 5-6 years since last time
- ◆ O'Reilly trained staff help customers pick correct auto parts – particularly hard parts (solid engine parts)
- ◆ Going to a store for advice is valuable to customer that is unsure what part to buy, however, customer returns may still be in low double digits
- ◆ Stores make it easier to find right part & return part if wrong one purchased





- ◆ Availability is primary factor in customer’s decision to purchase a part
- ◆ Stores carry approximately 23,000 SKUs – tailored to needs of market served by each individual store
- ◆ Deploys inventory dollars in greater breadth at store level (versus carrying greater depth of inventory)
- ◆ Breadth of inventory enables ability to have parts in stock when customers need it
- ◆ Stores typically have same day access to distribution centers if specific part isn’t in stock
- ◆ Getting a part as fast as possible is crucial for customers that may have severe vehicle maintenance issue

**DISTRIBUTION CENTERS**



**HUB STORES**



**STORES**



Source: O'Reilly company filings



# DIFM CUSTOMERS VALUE ADD



- ◆ DIFM customers are: automobile repair shops, garages, service stations or auto dealers
- ◆ Typically **hard parts** shipped to businesses versus DIFM customers going to a store
- ◆ Customers do not want to wait 1 day or even 4 hours
- ◆ Fast delivery enables automobile repair shops to repair vehicles faster & improve productivity
- ◆ O'Reilly can typically deliver parts to professional service providers in under 1 hour
- ◆ Do this by using stores as delivery nodes for professional service provider business

## O'REILLY TRUCKS



## HARD PARTS



## DIFM CUSTOMERS VALUE ADD (CONTINUED)



- ◆ Automobile repair shops have preferred suppliers they call on first
- ◆ First call/click can get more than 60% of business
- ◆ To be first call/click auto parts store has to build relationships with professional service providers
- ◆ Important to deliver the parts to DIFM customers quickly & provide great service
- ◆ O'Reilly has best in class inventory availability & consistently provides superior service

### O'REILLY FIRST CALL WEBSITE FOR THE PROFESSIONAL SERVICE PROVIDERS



# DUAL MARKET STRATEGY RESULTS ARE IN



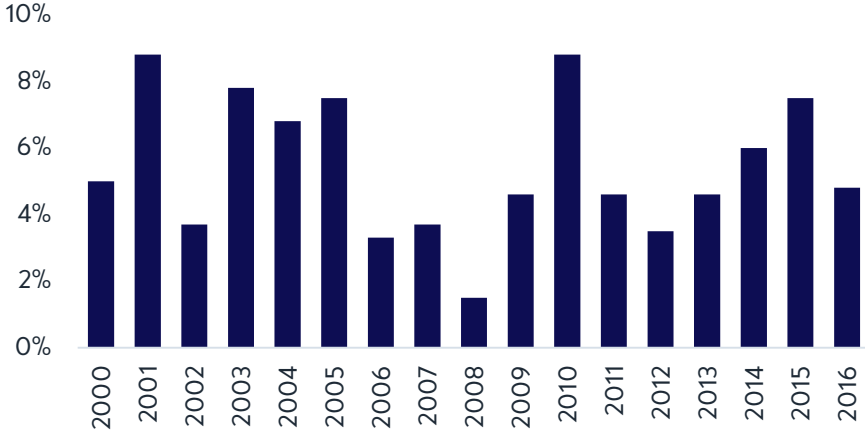
- ◆ Adds value with dual market strategy for both DIY & DIFM customers – can leverage retail & distribution infrastructure
- ◆ Generated strong same store sales growth over past decade
- ◆ Same store sales growth stronger than peers

## STRONGER SAME STORE SALES GROWTH THAN PEERS

Same Store Sales Growth	2012	2013	2014	2015	2016	5 Year Avg
O'Reilly	3.5%	4.6%	6.0%	7.5%	4.8%	5.3%
AutoZone	3.9%	0.0%	2.8%	3.8%	2.4%	2.6%
Advance Auto Parts	-0.8%	-1.5%	2.0%	0.0%	-1.4%	-0.3%

Source: Public company filings

## SAME STORE SALES GROWTH



Source: O'Reilly company filings

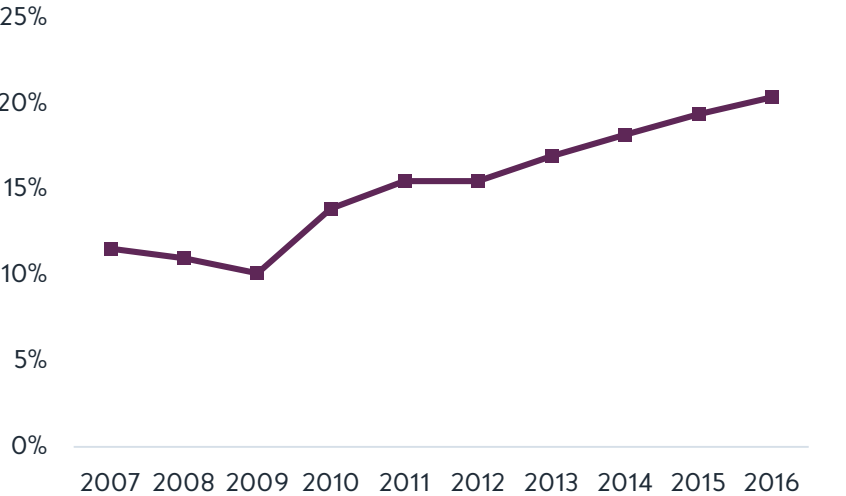


# BENEFITS FROM INCREASING SCALE



- ◆ CSK acquisition in 2008 increased scale & continued to open new stores
- ◆ Gained more negotiating leverage with vendors – result of large purchase volume increases
- ◆ With increasing scale – product acquisition costs continued to improve over time
- ◆ Enhanced gross margins – improved from 44.4% in 2007 to 52.5% in 2016
- ◆ Sales per weighted average square foot increased over time
- ◆ Adjusted operating margins increased due to higher gross margins & sales per average square foot
- ◆ Adjusted operating margins improved to 20.3% in 2016 from 11.5% in 2007

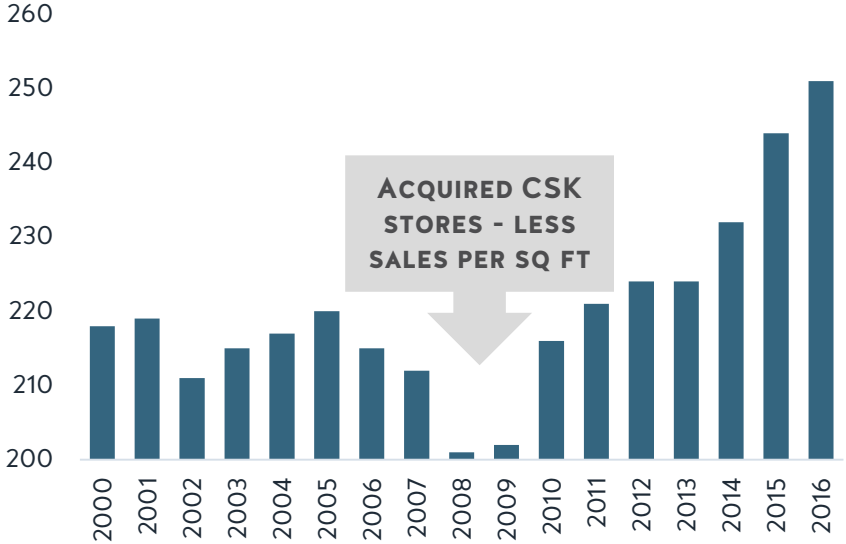
## ADJUSTED OPERATING MARGIN



Source: O'Reilly company filings and Centerstone analysis



## SALES PER WEIGHTED-AVERAGE SQUARE FOOT



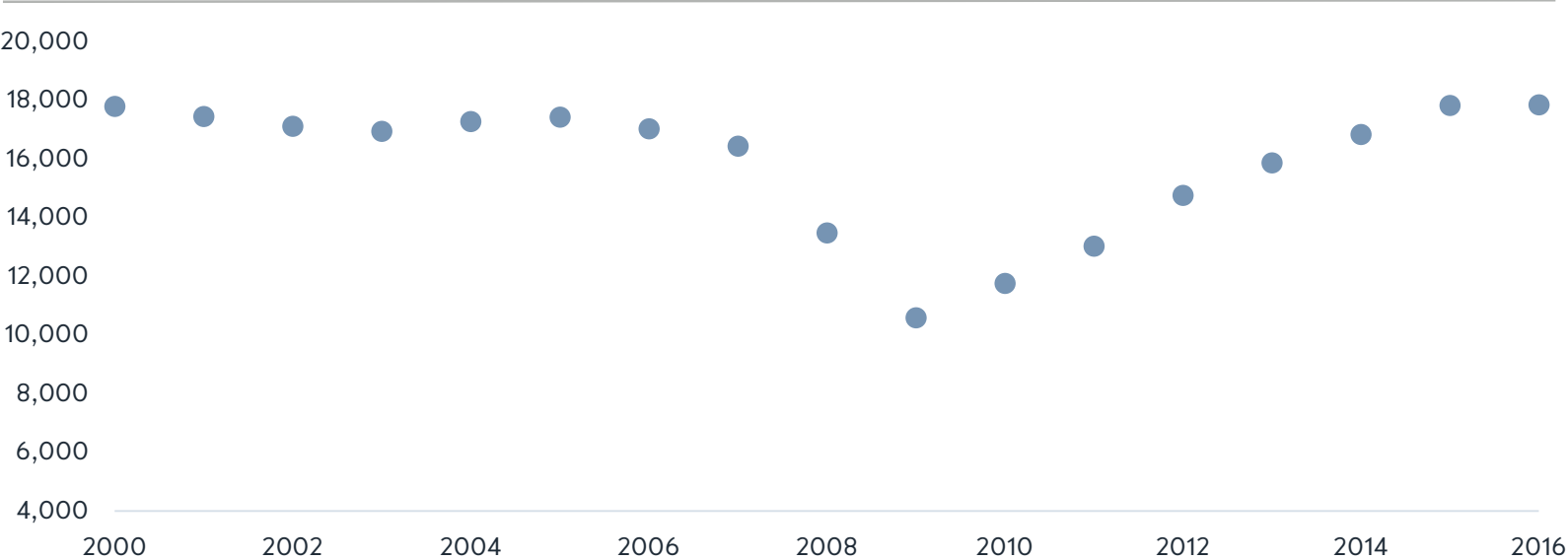
Source: O'Reilly company filings

# CYCLICAL HEADWINDS IMPROVING



- ◆ First 3 quarters of 2017 same store sales grew by only 1.5% (below ten-year average of 5%)
- ◆ 2 consecutive mild winters & mild summer in 2017
- ◆ New vehicle sales tend to affect O'Reilly with 6-year lag
- ◆ After 6 years vehicles typically have at least 60K to 70K miles on them & this is when parts fail
- ◆ New vehicle sales were weak from 2008-2011 & has been affecting results
- ◆ May be a headwind for the next few years - conditions should continue to improve going forward

## NEW VEHICLE SALES IN UNITS (1,000s)



Source: Bureau of Economic Analysis

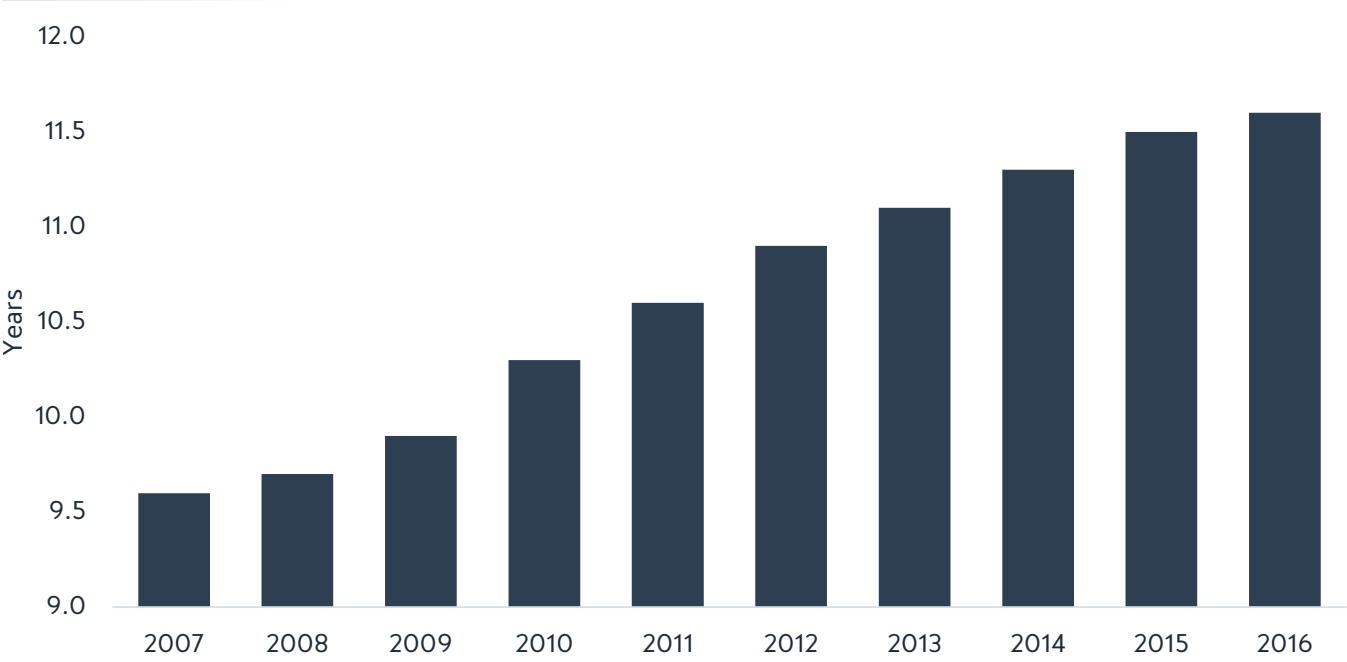


# VEHICLES ON THE ROAD GROWING OLDER



- ◆ Average age of US vehicle population increased from ~9.5 in 2007 to ~11.5 in 2016
- ◆ O'Reilly's core business is vehicles that are 6 years+
- ◆ Most vehicle warranties roll off after 4-5 years & industry benefits from people keeping vehicles longer
- ◆ Average age of vehicles on road is expected to modestly increase & is a long-term benefit for industry

## AVERAGE LIGHT VEHICLE AGE IN THE US



Source: 2018 ACA Factbook





- ◆ Remained focused on executing dual market strategy
- ◆ Disciplined in growing store base
- ◆ Expands distribution capacity to match store growth



- ◆ Stable management team
- ◆ Spreads out new store growth across US - selective in sites it develops & teams it chooses to run stores
- ◆ Makes opportunistic acquisitions to increase scale such as CSK

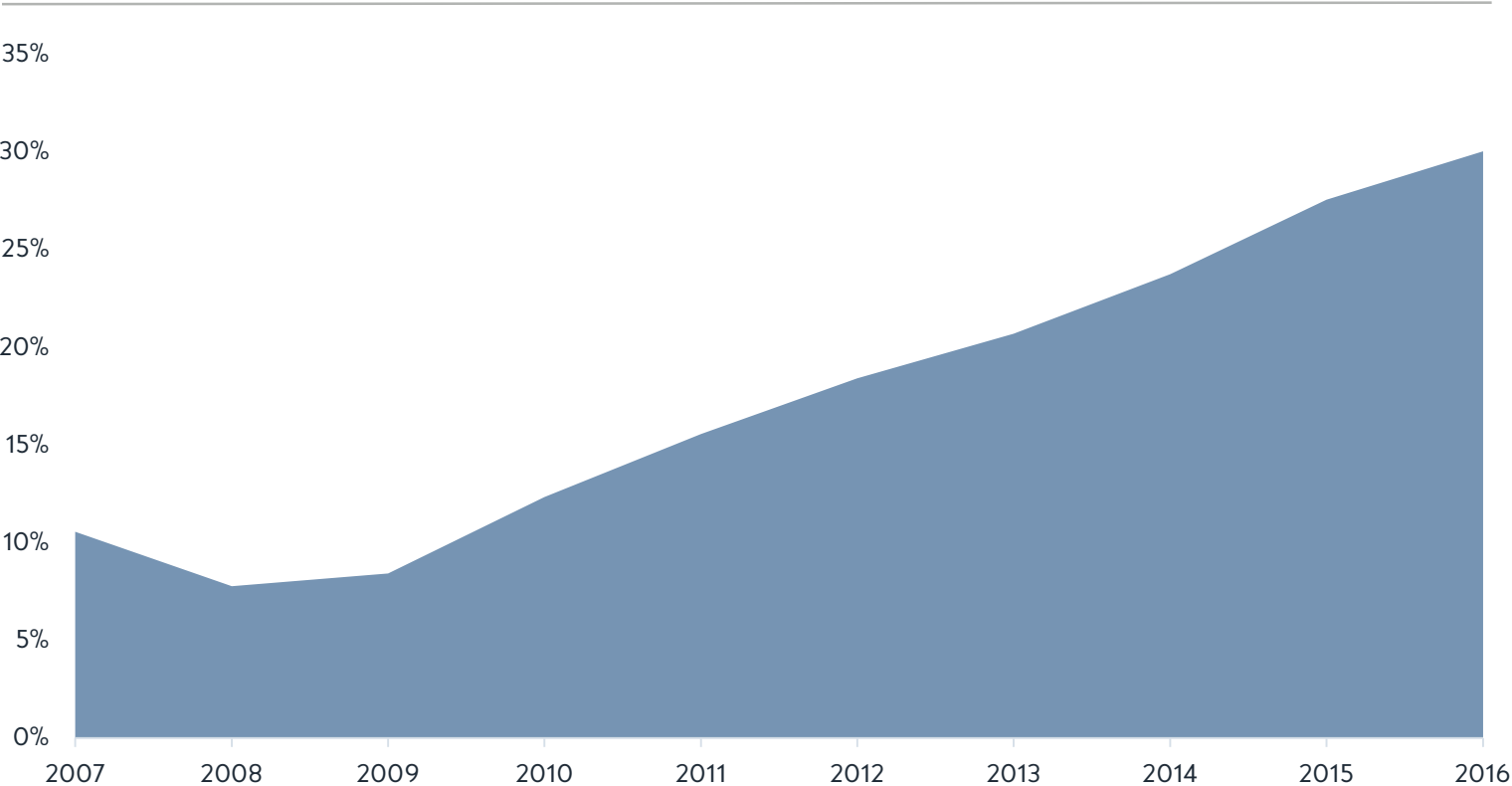


- ◆ Consistently return capital to shareholders
  - ◆ Returns excess capital to shareholders in the form of share repurchases
  - ◆ Average over \$1 billion per year in share repurchase since 2011



◆ Dual market strategy & opportunistic acquisitions have driven significant increase in return on invested capital over time

## RETURN ON INVESTED CAPITAL (ROIC)



Source: O'Reilly public filings and Centerstone analysis



# STRONG FINANCIAL POSITION



- ◆ Target capital structure adjusted debt to EBITDAR of 2-2.25x
- ◆ Strong cash flows & could potentially be debt free
- ◆ Used share repurchases to reach target capital structure
- ◆ Net debt to EBITDA lower than 1x



- ◆ Investment grade credit rating
- ◆ Uses strong financial position to enroll vendors into its enhanced vendor financing program
  - ◆ Program enabled negotiation for extended payment terms with vendors & improves working capital



- ◆ Owns nearly 40% of stores – removes some operating leverage from business model
- ◆ Owns approximately 70% of distribution centers



## REASONABLE VALUATION FOR A COMPOUNDER

- ◆ We believe O'Reilly is a compounder that can continue to grow its intrinsic equity value per share

Valuation Summary			
<i>In thousands, except per share amounts</i>			
	Low	Mid	High
Normalized EBIT	1,625,023	1,765,916	1,989,517
EBIT multiple	13x	13x	13x
<b>Intrinsic Equity Value Per Share</b>	<b>215.06</b>	<b>236.60</b>	<b>270.79</b>
<b>Market discount to intrinsic value</b>	<b>-10.6%</b>	<b>-1.6%</b>	<b>12.6%</b>

Source: O'Reilly company filings and Centerstone analysis

## DISCLOSURE

The commentary represents the opinion of Centerstone Investors as of January 2018 and is subject to change based on market and other conditions. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Any statistics contained here have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed. The views expressed herein may change at any time subsequent to the date of issue hereof. The information provided is not to be construed as a recommendation or an offer to buy or sell or the solicitation of an offer to buy or sell any fund or security.

There are risks associated with investing in securities of foreign countries, such as erratic market conditions, economic and political instability and fluctuations in currency exchange rates. These risks may be more pronounced with respect to investments in emerging markets.

Domestic economic growth and market conditions, interest rate levels, and political events are among the factors affecting US securities markets.

The principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value.

All investments involve the risk of loss of principal.

