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O REILLY AUTOMOTIVE INC

Form 10-Q

November 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

OR

() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-21318

O'REILLY AUTOMOTIVE, INC.

(Exact name of registrant as specified in its charter)

Missouri

(State or other jurisdiction)

44-0618012

(I.R.S. Employer Identification No.)

of incorporation or

organization)

233 South Patterson

Springfield, Missouri 65802

(Address of principal executive offices, Zip code)

(417) 862-6708

(Registrant's telephone number, including area code)

Not applicable

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(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Common stock, \$0.01 par value – 115,067,095 shares outstanding as of September 30, 2007.

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

FORM 10-Q

Quarter Ended September 30, 2007

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PART I - FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES**

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2007 (Unaudited)	December 31, 2007 (Note)
Assets		
Current assets:		
Cash and cash equivalents	\$ 109,783	\$ 29,903
Accounts receivable, net	90,654	81,048
Amounts receivable from vendors	46,334	47,790
Inventory	856,586	812,938
Other current assets	22,478	28,997
Total current assets	1,125,835	1,000,676
Property and equipment, at cost	1,416,573	1,214,854
Accumulated depreciation and amortization	370,630	331,759
Net property and equipment	1,045,943	883,095
Notes receivable, less current portion	26,765	30,288
Goodwill	49,857	49,065
Other assets	12,150	14,372
Total assets	\$ 2,260,550	\$ 1,977,496
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 401,308	\$ 318,404
Accrued payroll	26,334	21,171
Accrued benefits and withholdings	43,620	44,032
Deferred income taxes	9,299	5,779
Other current liabilities	48,074	44,089
Current portion of long-term debt	25,317	309
Total current liabilities	553,952	433,784
Long-term debt, less current portion	75,230	110,170
Deferred income taxes	25,896	38,171
Other liabilities	52,301	31,275

Shareholders' equity:

Common stock, \$0.01 par value:

Authorized shares – 245,000,000

Issued and outstanding shares – 115,067,095 as of

September 30, 2007, and 113,929,327 as of

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December 31, 2006	1,151	1,139
Additional paid-in capital	436,222	400,552
Retained earnings	1,115,798	962,405
Total shareholders' equity	1,553,171	1,364,096
Total liabilities and shareholders' equity	\$ 2,260,550	\$ 1,977,496

See "Notes to Condensed Consolidated Financial Statements"

Note: The balance sheet at December 31, 2006, has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

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O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Sales	\$ 661,778	\$ 597,144	\$ 1,918,031	\$ 1,724,890
Cost of goods sold, including warehouse and distribution expenses	368,077	333,818	1,067,864	967,208
Gross profit	293,701	263,326	850,167	757,682
Operating, selling, general and administrative expenses	210,985	188,242	608,701	539,396
Operating income	82,716	75,084	241,466	218,286
Other income (expense), net	756	272	1,527	(18)
Income before income taxes	83,472	75,356	242,993	218,268
Provision for income taxes	30,385	27,500	89,600	80,535
Net income	\$ 53,087	\$ 47,856	\$ 153,393	\$ 137,733
Net income per common share	\$ 0.46	\$ 0.42	\$ 1.34	\$ 1.22
Net income per common share-assuming dilution	\$ 0.46	\$ 0.42	\$ 1.32	\$ 1.20
Weighted-average common shares outstanding	114,946	113,464	114,508	113,084
Adjusted weighted-average common shares outstanding – assuming dilution	116,306	115,026	115,989	114,949

See "Notes to Condensed Consolidated Financial Statements"

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2007	2006
Net cash provided by operating activities	\$ 281,908	\$ 159,795
Investing activities:		
Purchases of property and equipment	(219,630)	(174,867)
Proceeds from sale of property and equipment	1,834	609
Payments received on notes receivable	3,857	3,865
Investment in other assets	(2,536)	(2,173)
Net cash used in investing activities	(216,475)	(172,566)
Financing activities:		
Proceeds from issuance of long-term debt	16,450	79,250
Tax benefit of stock options exercised	6,170	7,016
Principal payments on long-term debt	(26,382)	(80,113)
Net proceeds from issuance of common stock	18,209	16,057
Net cash provided by financing activities	14,447	22,210
Net increase in cash and cash equivalents	79,880	9,439
Cash and cash equivalents at beginning of period	29,903	31,384
Cash and cash equivalents at end of period	\$ 109,783	\$ 40,823

See "Notes to Condensed Consolidated Financial Statements"

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 30, 2007

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of O'Reilly Automotive, Inc. and Subsidiaries (the "Company") have been prepared in accordance with United States generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2007, are not necessarily indicative of the results that may be expected for the year ended December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

2. Reclassifications

The Company made certain reclassifications to prior periods to conform to current year presentation.

3. Stock-based Employee Compensation Plans

In accordance with Statement of Financial Accounting Standards No. 123R, *Share Based Payment* ("SFAS No. 123R"), the Company recognizes share-based compensation expense based on the fair value of the awards. Share-based payments include stock option awards issued under the Company's employee stock option plan, director stock option plan, stock issued through the Company's employee stock purchase plan and stock awarded to employees through other benefit programs.

Stock Options

The Company's employee stock-based incentive plan provides for the granting of stock options for the purchase of common stock of the Company to directors and certain key employees of the Company. Options are granted at an exercise price that is equal to the market value of the Company's common stock on the date of the grant. Director options granted under the plan expire after seven years and are fully vested after six months. Employee options granted under the plan expire after ten years and typically vest 25% a year, over four years. The Company records compensation expense for the grant date fair value of option awards evenly over the vesting period under the straight-line method. The following table summarizes the stock option transactions during the first nine months of 2007:

Shares	Weighted-Average Exercise Price
--------	------------------------------------

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Outstanding at December 31, 2006	6,640,745	\$ 20.31
Granted	1,155,675	33.98
Exercised	(908,017)	16.26
Forfeited	(476,963)	27.11
Outstanding at September 30, 2007	6,411,440	22.89
Exercisable at September 30, 2007	4,765,998	\$ 19.27

The Company recognized stock option compensation costs of approximately \$1,562,000 and \$4,225,000 for the three and nine months ended September 30, 2007, respectively and stock option compensation costs of approximately \$865,000 and \$1,973,000 for the three and nine months ended September 30, 2006, respectively. The Company recognized a corresponding income tax benefit of approximately \$578,000 and \$1,566,000 for the three and nine months ended September 30, 2007, respectively, and a corresponding income tax benefit of approximately \$319,000 and \$731,000 for the three and nine months ended September 30, 2006, respectively.

The fair value of each stock option grant is estimated on the date of the grant using the Black-Scholes option pricing model. The Black-Scholes model requires the use of assumptions, including expected volatility, expected life, the risk free rate and the expected dividend yield. Expected volatility is based upon the historical volatility of the Company's stock. Expected life represents the period of time that options granted are expected to be outstanding. The Company uses historical data and experience to estimate the expected life of options granted. The risk free interest rates for periods within the contractual life of the options are based on the United States Treasury rates in effect for the expected life of the options.

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

September 30, 2007

Stock-based Employee Compensation Plans – (continued)*Stock Options – (continued)*

The following weighted-average assumptions were used for grants issued during the first nine months of 2007 and 2006 respectively:

	2007		2006	
Risk free interest rate	4.6	%	3.9	%
Expected life	4.5	Years	4.7	Years
Expected volatility	34.1	%	35.1	%
Expected dividend yield	0	%	0	%

The weighted-average grant-date fair value of options granted during the first nine months of 2007 was \$12.28 compared to \$11.69 for the first nine months of 2006. The remaining unrecognized compensation cost related to unvested awards at September 30, 2007, was \$17,638,000 and the weighted-average period of time over which this cost will be recognized is 3.0 years.

Other Employee Benefit Plans

The Company sponsors other share-based employee benefit plans including a contributory profit sharing and savings plan that covers substantially all employees, an employee stock purchase plan which permits all eligible employees to purchase shares of the Company's common stock at 85% of the fair market value and a performance incentive plan under which the Company's senior management is awarded shares of restricted stock that vest equally over a three-year period. Compensation expense recognized under these plans is measured based on the market price of the Company's common stock on the date of award and is recorded over the vesting period. During the three and nine months ended September 30, 2007, the Company recorded approximately \$1,995,000 and \$5,912,000 of compensation cost for benefits provided under these plans and a corresponding income tax benefit of approximately \$738,000 and \$2,191,000 respectively. During the three and nine months ended September 30, 2006, the Company recorded approximately \$1,767,000 and \$5,562,000 of compensation cost for benefits provided under these plans and recognized a corresponding income tax benefit of approximately \$646,000 and \$2,049,000, respectively.

4. Synthetic Lease Facility

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On September 28, 2007, the Company completed a second amended and restated master agreement to its \$49 million Synthetic Operating Lease Facility with a group of financial institutions. The terms of such lease facility provide for an initial lease period of seven years, a residual value guarantee of approximately \$39.7 million at September 30, 2007 and purchase options on the properties. The lease facility also contains a provision for an event of default whereby the lessor, among other things, may require the Company to purchase any or all of the properties. One additional renewal period of seven years may be requested from the lessor, although the lessor is not obligated to grant such renewal. The second amended and restated Facility has been accounted for as an operating lease under SFAS No. 13 and related interpretations, including FASB Interpretation No. 46R.

5. Goodwill

At September 30, 2007 and December 31, 2006, the value of the Company's goodwill was as follows:

	(In thousands)
Balance at December 31, 2006	\$ 49,065
Acquisitions	792
Balance at September 30, 2007	\$ 49,857

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

September 30, 2007

6. Income Per Common Share

The following table sets forth the computation of basic and diluted income per common share for the three and nine months ended September 30:

	For the three months ended September 30,		For the nine months ended September 30,	
	2007	2006	2007	2006
(In thousands, except per share data)				
Numerator (basic and diluted):				
Net income	\$ 53,087	\$ 47,856	\$ 153,393	\$ 137,733
Denominator:				
Denominator for basic income per common share -				
weighted-average shares	114,946	113,464	114,508	113,084
Effect of stock options	1,360	1,562	1,480	1,865
Denominator for diluted income per common share -				
adjusted weighted-average shares and assumed				
conversion	116,306	115,026	115,989	114,949
Basic net income per common share	\$ 0.46	\$ 0.42	\$ 1.34	\$ 1.22
Net income per common share-assuming dilution	\$ 0.46	\$ 0.42	\$ 1.32	\$ 1.20

7. Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and a measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. For a benefit to be recognized, a tax position must be more-likely-than-not to be sustainable upon examination by the applicable taxing authority. Additionally, FIN No. 48 provides guidance on derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The Company adopted the provisions of FIN 48 on January 1, 2007. No adjustment was required in the liability for unrecognized income tax benefits as a result of the implementation of FIN 48. At the adoption date of January 1, 2007, the Company had a gross exposure for unrecognized tax benefits of \$14.9 million and a related \$4.9 million deferred tax asset for the corresponding potential future tax deduction related to the gross exposure (for a net \$10.0 million of unrecognized tax benefits) which would affect the Company's effective tax rate if recognized. At September 30, 2007, the

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Company had a gross exposure for unrecognized tax benefits accrued of \$18.7 million and a related \$6.4 million deferred tax asset for the corresponding potential future tax deduction related to the gross exposure (for a net \$12.3 million of unrecognized tax benefits) which would affect the Company's effective tax rate if recognized. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2007, the Company had approximately \$2.4 million of accrued interest and penalties related to uncertain tax positions, before the benefit of the deduction for interest on state and federal returns. Although unrecognized tax benefits for individual tax positions may increase or decrease during 2007, the Company does not anticipate significant increases or decreases to the total amount of unrecognized tax benefits during 2007 or for the one year period subsequent to September 30, 2007.

The Company's U.S. federal income tax returns for tax years 2005 and beyond remain subject to examination by the Internal Revenue Service ("IRS"). The IRS concluded an examination of the Company's consolidated 2002, 2003 and 2004 federal income tax returns in the first quarter of 2007. The statute of limitations for the Company's federal income tax returns for tax years 2003 and prior have expired. The statute of limitations for the Company's U.S. federal income tax return for 2004 will expire on September 15, 2008, unless otherwise extended. The Company's state income tax returns remain subject to examination by various state authorities for tax years ranging from 2001 through 2006.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Unless otherwise indicated, "we," "us," "our" and similar terms, as well as references to the "Company" or "O'Reilly" refer to O'Reilly Automotive, Inc. and its subsidiaries.

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, selling our products to both do-it-yourself customers and professional installers. At September 30, 2007, we operated 1,744 stores in Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, North Carolina, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, Virginia, Wisconsin and Wyoming. Our stores carry an extensive line of products consisting of new and remanufactured automotive hard parts and accessories and a complete line of auto body paint and related materials, automotive tools and professional service equipment. We do not sell tires or perform automotive repairs or installations.

Forward-Looking Statements

We claim the protection of the safe-harbor for forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as "expect," "believe," "anticipate," "should," "plan," "intend," "estimate," "project" or similar words. In addition, statements contained within this annual report that are not historical facts are forward-looking statements, such as statements discussing among other things, expected growth, store development and expansion strategy, business strategies, future revenues and future performance. These forward-looking statements are based on estimates, projections, beliefs and assumptions and are not guarantees of future events and results. Such statements are subject to risks, uncertainties and assumptions, including, but not limited to, competition, product demand, the market for auto parts, the economy in general, inflation, consumer debt levels, governmental approvals, our ability to hire and retain qualified employees, risks associated with the integration of acquired businesses, weather, terrorist activities, war and the threat of war. Actual results may materially differ from anticipated results described or implied in these forward-looking statements. Please refer to the "Risk Factors" section of our annual report on Form 10-K for the year ended December 31, 2006, for additional factors that could materially affect our financial performance.

Critical Accounting Policies and Estimates

The preparation of our financial statements in accordance with accounting policies generally accepted in the United States ("GAAP") requires the application of certain estimates and judgments by management. Management bases its assumptions, estimates, and adjustments on historical experience, current trends and other factors believed to be relevant at the time the consolidated financial statements are prepared. Management believes that the following policies are critical due to the inherent uncertainty of these matters and the complex and subjective judgments required to establish these estimates. Management continues to review these critical accounting policies and estimates to ensure that the consolidated financial statements are presented fairly in accordance with GAAP. However, actual results could differ from our assumptions and estimates and such differences could be material.

- **Vendor concessions** – We receive concessions from our vendors through a variety of programs and arrangements, including co-operative advertising, allowances for warranties, merchandise allowances and volume purchase rebates. Co-operative advertising allowances that are incremental to our advertising program, specific to a product or event and identifiable for accounting purposes, are reported as a reduction of advertising expense in the period in which the advertising occurred. All other vendor concessions are recognized as a reduction to the cost of inventory. Amounts receivable from vendors also include amounts due to us relating to vendor purchases and product returns. Management regularly reviews amounts receivable from vendors and assesses the need for a reserve for uncollectible amounts based on our evaluation of our vendors' financial position and corresponding ability to meet their financial obligations. Based on our historical results and current assessment, we have not recorded a reserve for uncollectible amounts in our consolidated financial statements, and we do not believe there is a reasonable likelihood that our ability to collect these amounts will differ from our expectations. The eventual ability of our vendors to pay us the obliged amounts could differ from our assumptions and estimates, and we may be exposed to losses or gains that could be material.
- **Self-Insurance Reserves** – We use a combination of insurance and self-insurance mechanisms to provide for potential liabilities related to workers' compensation, general liability, vehicle liability, property loss, and employee health care benefits. With the exception of employee health care benefit liabilities, which are limited by the design of these plans, we obtain third-party insurance coverage to limit our exposure for any individual claim. When estimating our self-insurance liabilities, we consider a number of factors, including historical claims experience and trend-lines, projected medical and legal inflation and growth patterns and exposure forecasts. The assumptions made by management as they relate to each of these factors represents our judgment as to the most probable cumulative impact of each factor on our future obligations. Our calculation of our self-

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

● **Self-Insurance Reserves (continued)**

insurance liabilities requires management to apply judgment to estimate the ultimate cost to settle reported claims and claims incurred but not yet reported as of the balance sheet date and the application of alternative assumptions would result in a different estimate of these liabilities. Actual claim activity or development may vary from our assumptions and estimates, which may result in material losses or gains. As we obtain additional information that affects the assumptions and estimates we used to recognize liabilities for claims incurred in prior accounting periods, we adjust our self-insurance liabilities to reflect the revised estimates based on this additional information. If self-insurance reserves were changed 10% from our estimated reserves at December 31, 2006, the financial impact would have been approximately \$4.5 million or 1.6% of pretax income.

- **Accounts receivable** – Management estimates the allowance for doubtful accounts based on historical loss ratios and other relevant factors. Actual results have consistently been within management's expectations, and we do not believe that there is a reasonable likelihood that there will be a material change in the future that will require a significant change in the assumptions or estimates we use to calculate our allowance for doubtful accounts. However, if actual results differ from our estimates, we may be exposed to losses or gains. If the allowance for doubtful accounts were changed 10% from our estimated allowance at December 31, 2006, the financial impact would have been approximately \$0.3 million or 0.1% of pretax income.
- **Taxes** – We operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions. These audits can involve complex issues, which may require an extended period of time to resolve. We regularly review our potential tax liabilities for tax years subject to audit. The amount of such liabilities is based on various factors, such as differing interpretations of tax regulations by the responsible tax authority, experience with previous tax audits and applicable tax law rulings. Changes in our tax liability may occur in the future as our assessments change based on the progress of tax examinations in various jurisdictions and/or changes in tax regulations. In management's opinion, adequate provisions for income taxes have been made for all years presented. The estimates of our potential tax liabilities contain uncertainties because management must use judgment to estimate the exposures associated with our various tax positions and actual results could differ from our estimates. Alternatively, we could have applied assumptions regarding the eventual outcome of the resolution of open tax positions that would differ from our current estimates but that would still be reasonable given the nature of a particular position. Our judgment regarding the most likely outcome of uncertain tax positions has historically resulted in an estimate of our tax liability that is greater than actual results. While our estimates are subject to the uncertainty noted in the preceding discussion, our initial estimates of our potential tax liabilities have historically not been materially different from actual results except in instances where we have reversed liabilities that were recorded for periods that were subsequently closed with the applicable taxing authority.
- **Share-based compensation** – Prior to January 1, 2006, we accounted for share-based compensation plans under the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25"), as permitted under Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123*. Effective January 1, 2006, we adopted SFAS No. 123R, "Share Based Payment," under the modified prospective method. Accordingly, prior period amounts have not been restated. Under this application, we record share-based compensation expense for all awards granted on or after the date of adoption and for the portion of previously granted awards that remain unvested at the date of adoption. Currently, our share-based compensation relates to stock option awards, employee share purchase plan discounts, restricted stock awards and shares contributed directly to other employee benefit plans.

Under SFAS No. 123R, we use a Black-Scholes option-pricing model to determine the fair value of stock options. The Black-Scholes model includes various assumptions, including the expected life of stock options, the expected volatility and the expected risk-free interest rate. These assumptions reflect our best estimates, but they involve inherent uncertainties based on market conditions generally outside our control. Since our adoption of SFAS No. 123R, share-based compensation cost would not have been materially impacted by the variability in the range of reasonable assumptions we could have made to value option award grants, but we anticipate that share-based compensation cost could be

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materially impacted by the application of alternate assumptions in future periods. Also, under SFAS No. 123R, we are required to record share-based compensation expense net of estimated forfeitures. Our forfeiture rate assumption used in determining share-based compensation expense is estimated based on historical data. The actual forfeiture rate and corresponding share-based compensation expense could differ from those estimates.

- **Inventory Obsolescence and Shrink** – Inventory, which consists of automotive hard parts, maintenance items, accessories and tools is stated at the lower of cost or market. The extended nature of the life cycle of our products is such that the risk of obsolescence of our inventory is minimal. The products that we sell generally have application in our markets for a relatively long period of time in conjunction with the corresponding vehicle population. We have developed sophisticated systems for

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

● **Inventory Obsolescence and Shrink (continued)**

monitoring the life cycle of a given product and, accordingly, have historically been very successful in adjusting the volume of our inventory in conjunction with a decrease in demand. We do record a reserve to reduce the carrying value of our inventory through a charge to cost of sales in the isolated instances where we believe that the market value of a product line is lower than our recorded cost. This reserve is based on our assumptions about the marketability of our existing inventory and is subject to uncertainty to the extent that we must estimate, at a given point in time, the market value of inventory that will be sold in future periods. Ultimately, our projections could differ from actual results and could result in a material impact to our stated inventory balances. We have historically not had to materially adjust our obsolescence reserves due to the factors discussed above and do not anticipate that we will experience material changes in our estimates in the future.

We also record a reserve to reduce the carrying value of our perpetual inventory to account for quantities in our perpetual records above the actual existing quantities caused by unrecorded shrink. We estimate this reserve based on the results of our extensive and frequent cycle counting programs and periodic full physical inventories at our stores and distribution centers. To the extent that our estimates do not accurately reflect the actual inventory shrinkage, we could potentially experience a material impact to our reported inventory balances. We have historically been able to provide a timely and accurate measurement of shrink and have not experienced material adjustments to our estimates. If unrecorded shrink at December 31, 2006 were double the estimate that we recorded based on our historical experience, the financial impact would have been less than \$2 million or less than 0.7% of pretax income.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Results of Operations

Sales increased \$65 million, or 10.8% from \$597 million in the third quarter of 2006, to \$662 million in the third quarter of 2007. Sales for the first nine months of 2007 were \$1.92 billion, an increase of \$193 million or 11.2% over sales for the first nine months of 2006. A 4.3% increase in comparable store sales for both the first three and nine months of 2007 provided \$24.6 million and \$71.5 million of the three and nine month sales increase, respectively. Comparable store sales are calculated based on the change in sales of stores open at least one year and exclude sales of specialty machinery, sales to independent parts stores and sales to team members. We believe that the comparable store sales increase is primarily attributable to our offering of a broader selection of products in most stores, an increased promotional and advertising effort through a variety of media and localized promotional events, continued improvement in the merchandising and store layouts of most stores, and compensation programs for all store team members that provide incentives for performance. The addition of 134 net new stores opened in the first nine months of 2007 added \$23.6 million and \$41.9 million to the three and nine month sales increase, respectively. Finally, a full three and nine months of sales for stores opened throughout 2006, excluding sales which are included in our comparable store sales totals, contributed an additional \$16.8 million and \$79.2 million to the three and nine month sales increase, respectively. At September 30, 2007, we operated 1,744 stores compared to 1,596 stores at September 30, 2006. We anticipate that continued store unit and sales growth consistent with our historical rates will continue in the future.

Gross profit increased \$30 million, or 11.5% from \$263 million (or 44.1% of sales) in the third quarter of 2006 to \$294 million (or 44.4% of sales) in the third quarter of 2007. Gross profit for the first nine months increased 12.2% to \$850 million (or 44.3% of sales) in 2007, from \$758 million (or 43.9% of sales) in 2006. The increase in gross profit dollars was primarily a result of the increase in sales resulting from the increase in the number of stores open during the third quarter and first nine months of 2007 compared to the same period in 2006 and increased sales levels at existing stores. The increase in gross profit as a percentage of sales is the result of improved product mix, lower product acquisition cost and distribution system improvements. We improved our product mix by continuing to implement strategies to differentiate our merchandise selections at each store based on customer demand and vehicle demographics in the store's market and through ongoing Team Member training initiatives focused on selling products with greater gross margin contribution. Product acquisition cost improved due to increased imports from lower cost providers in foreign countries as well as improved negotiating leverage with our vendors as a result of our growth. Improvements in our distribution system were the result of capital projects designed to create operating expense efficiencies. We anticipate these trends to continue at a moderate rate throughout the remainder of 2007.

Operating, selling, general and administrative expenses ("OSG&A expenses") increased \$23 million, or 12.1% from \$188 million (or 31.5% of sales) in the third quarter of 2006 to \$211 million (or 31.9% of sales) in the third quarter of 2007. OSG&A expenses increased \$69 million, or 12.8% from \$539 million (or 31.3% of sales) in the first nine months of 2006 to \$609 million (or 31.7% of sales) in the first nine months of 2007. The dollar increase in OSG&A expenses resulted primarily from additional team members and resources to support our increased store count. The increase in OSG&A expenses as a percentage of sales in the third quarter and for the first nine months of 2007 was primarily due to increased store pre-opening salaries, higher advertising costs and increased stock compensation expense.

Our estimated provision for income taxes increased \$2.9 million to \$30.4 million for the third quarter 2007 compared to \$27.5 million for the same period in 2006. Our provision for income taxes increased \$9.1 million to \$89.6 million for the first nine months of 2007 compared to \$80.5 million for the first nine months of 2006. These increases are the result of our increased taxable income. Our effective tax rate was 36.4% of income before income taxes for the third quarter of 2007 versus 36.5% for the same period in 2006. Our effective tax rate for the first nine months of both 2007 and 2006 was 36.9%.

Liquidity and Capital Resources

Net cash provided by operating activities increased from \$159.8 million for the first nine months in 2006 to \$281.9 million for the first nine months of 2007. This increase was principally due to increased net income and a reduction in net inventory investment. Net inventory investment reflects our investment in inventory net of the amount of accounts payable to vendors. The reduction in net inventory investment is the result of reductions in our per store inventory levels and our ongoing effort to extend payment terms with our vendors.

Net cash used in investing activities increased from \$172.6 million during the first nine months in 2006 to \$216.5 million for the comparable period in 2007, due to increases in capital expenditures resulting from our ongoing store expansion program, store relocations and enhancements to existing store technology. Our store expansion program resulted in the addition of 134 new stores in the first nine months of 2007 compared to the addition of 126 new stores for the same period in 2006. During the first nine months of 2007, we relocated 30 stores compared to the relocation of 13 stores during the same period in 2006. Enhancements to existing store technology include the roll out of our new point of sale system as well as hardware upgrades.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Liquidity and Capital Resources (continued)

Net cash provided by financing activities decreased from \$22.2 million during the first nine months of 2006 to \$14.4 million for the same period in 2007. The decrease in cash flows from financing activities is the result of a greater amount of repayment of long-term debt during the first nine months of 2007 versus the comparable period in 2006.

We have available an unsecured, five-year syndicated revolving credit facility in the amount of \$100 million. The credit facility may be increased at our request to a total of \$200 million, subject to availability of such additional credit from either existing banks within the credit facility or other banks. At September 30, 2007, there were no outstanding borrowings under the revolving credit facility. Letters of credit totaling \$31.6 million were outstanding under the credit facility at September 30, 2007. Accordingly, we have aggregate availability for additional borrowings of \$68.4 million under the revolving credit facility. The revolving credit facility, which bears interest at LIBOR plus a spread ranging from 0.375% to 0.75% (5.688% at September 30, 2007), expires in July 2010.

Our continuing store expansion program requires significant capital expenditures and working capital principally for inventory requirements. The costs associated with opening a new store (including the cost of land acquisition, improvements, fixtures, net inventory investment and computer equipment) are estimated to average approximately \$1.1 to \$1.3 million; however, such costs may be significantly reduced where we lease, rather than purchase, the store site. We plan to finance our expansion program through cash expected to be provided from operating activities and available borrowings under our existing credit facilities.

During the third quarter of 2007, we opened 43 new stores. We plan to open approximately 56 additional stores during the remainder of 2007. The funds required for such planned expansions are expected to be provided by existing cash balances, cash generated from operating activities and the existing and available bank credit facilities.

We believe that our existing cash, short-term investments, cash expected to be provided by operating activities, available bank credit facilities and trade credit will be sufficient to fund both our short-term and long-term capital and liquidity needs for the foreseeable future.

Contractual Obligations

At September 30, 2007, we had long-term debt with maturities of less than one year of \$25,317,000 and long-term debt with maturities over one year of \$75,230,000, representing a total decrease in all outstanding debt of \$9,932,000 from December 31, 2006.

New Accounting Standards

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and a measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. For a benefit to be recognized, a tax position must be more-likely-than-not to be sustainable upon examination by the applicable taxing authority. Additionally, FIN No. 48 provides guidance on derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. We adopted the provisions of FIN 48 on January 1, 2007. No adjustment was required in the liability for unrecognized income tax benefits as a result of the implementation of FIN 48. At the adoption date of January 1, 2007, we had a gross exposure for unrecognized tax benefits of \$14.9 million and a related \$4.9 million deferred tax asset for the corresponding potential future tax deduction related to the gross exposure (for a net \$10.0 million of unrecognized tax benefits) which would affect our effective tax rate if recognized. At September 30, 2007, we had a gross exposure for unrecognized tax benefits accrued of \$18.7 million and a related \$6.4 million deferred tax asset for the corresponding potential future tax deduction related to the gross exposure (for a net \$12.3 million of unrecognized tax benefits) which would affect our effective tax rate if recognized. We recognize interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2007, we had approximately \$2.4 million of accrued interest and penalties related to uncertain tax positions, before the benefit of the deduction for interest on state and federal returns. Although unrecognized tax benefits for individual tax positions may increase or decrease during 2007, we do not anticipate significant increases or decreases to the total amount of unrecognized tax benefits during 2007 or for the one year period subsequent to September 30, 2007.

Our U.S. federal income tax returns for tax years 2005 and beyond remain subject to examination by the Internal Revenue Service ("IRS"). The IRS concluded an examination of our consolidated 2002, 2003 and 2004 federal income tax returns in the first quarter of 2007. The statute of limitations for our federal income tax returns for tax years 2003 and prior have expired. The statute of limitations for our U.S. federal income tax return for 2004 will expire on September 15, 2008, unless otherwise extended. Our income tax returns remain subject to examination by various state authorities for tax years ranging from 2001 through 2006.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**

Inflation and Seasonality

We attempt to mitigate the effects of merchandise cost increases principally by adjustments to our retail prices. We will also take advantage of vendor incentive programs, economies of scale resulting from increased volume of purchases and selective forward buying. As a result, we do not believe that our operations have been materially affected by inflation. Our business is somewhat seasonal, primarily as a result of the impact of weather conditions on customer buying patterns. Store sales and profits have historically been higher in the second and third quarters (April through September) of each year than in the first and fourth quarters.

Internet Address and Access to SEC Filings

Our Internet address is www.oreillyauto.com. Interested readers can access our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, through the Security and Exchange Commission's website at www.sec.gov. Such reports are generally available on the day they are filed. Additionally, we will furnish interested readers upon request and free of charge, a paper copy of such reports.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to interest rate risk to the extent we borrow against our revolving credit facility with variable interest rates. Since no amounts were outstanding under the revolving credit facility at September 30, 2007, changes in interest rates would not have any effect. In the event of an adverse change in interest rates and assuming the Company had amounts outstanding under the credit facility, management would likely take actions that would mitigate our exposure to interest rate risk particularly if our borrowing levels increase to any significant extent; however, due to the uncertainty of the actions that would be taken and their possible effects, this analysis assumes no such action. Further, this analysis does not consider the effects of the change in the level of overall economic activity that could exist in such an environment.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures as required by Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act,") as of September 30, 2007. Based on such review and evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective as of September 30, 2007, to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act (a) is recorded, processed, summarized and reported within the time period specified in the Securities and Exchange Commission's rules and forms and (b) is accumulated and communicated to the Company's management, including the principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. There were no material changes in the Company's internal control over financial reporting during the third quarter of 2007 that have materially affected or are reasonably likely to materially affect the Company's internal controls over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not a party to any legal proceedings, other than routine claims and lawsuits arising in the ordinary course of our business. We do not believe such claims and lawsuits, individually or in the aggregate, will have a material adverse effect on our business.

ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2006.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibits:

<u>Number</u>	<u>Description</u>	<u>Page</u>
31.1	Certificate of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.	20
31.2	Certificate of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.	21
32.1	Certificate of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.	22
32.2	Certificate of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.	23

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

O'REILLY AUTOMOTIVE, INC.

November 9, 2007

Date

/s/ Greg Henslee

Greg Henslee, Co-President and Chief Executive

Officer (Principal Executive Officer)

November 9, 2007

Date

/s/ Thomas McFall

Thomas McFall, Senior Vice-President of Finance and

Chief Financial Officer (Principal Financial and

Accounting Officer)

INDEX TO EXHIBITS

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O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

Exhibit 31.1 – CEO Certification

CERTIFICATIONS

I, Greg Henslee, certify that:

1. I have reviewed this report on Form 10-Q of O'Reilly Automotive, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2007

/s/ Greg Henslee
Greg Henslee, Co-President and Chief
Executive Officer (Principal Executive Officer)

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

Exhibit 31.2 – CFO Certification

CERTIFICATIONS

I, Thomas McFall, certify that:

1. I have reviewed this report on Form 10-Q of O'Reilly Automotive, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2007

/s/ Thomas McFall

Thomas McFall, Senior Vice President of Finance

and Chief Financial Officer (Principal Financial and

Accounting Officer)

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

Exhibit 32.1 – CEO Certification

O'REILLY AUTOMOTIVE, INC.

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the report of O'Reilly Automotive, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Greg Henslee, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Greg Henslee
Greg Henslee
Chief Executive Officer

(Principal Executive Officer)

November 9, 2007

The foregoing certification is being furnished as an exhibit to the Report pursuant to Item 601(b)(32) of Regulation S-K and Section 1350 of Title 18 of the United States Code and, accordingly, is not being filed with the Securities and Exchange Commission (the "Commission") as part of the Report and is not to be incorporated by reference into any filing of the Company with the Commission, whether made before or after the date of the Report, irrespective of any general incorporation language contained in such filing.

O'REILLY AUTOMOTIVE, INC. AND SUBSIDIARIES

Exhibit 32.2 – CFO Certification

O'REILLY AUTOMOTIVE, INC.

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the report of O'Reilly Automotive, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Thomas McFall, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Thomas McFall
Thomas McFall
Chief Financial Officer

(Principal Financial and Accounting Officer)

November 9, 2007

The foregoing certification is being furnished as an exhibit to the Report pursuant to Item 601(b)(32) of Regulation S-K and Section 1350 of Title 18 of the United States Code and, accordingly, is not being filed with the Securities and Exchange Commission (the "Commission") as part of the Report and is not to be incorporated by reference into any filing of the Company with the Commission, whether made before or after the date of the Report, irrespective of any general incorporation language contained in such filing.