

CARMAX INC  
Form 10-Q  
July 08, 2015  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended May 31, 2015

OR

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

Commission File Number: 1-31420

CARMAX, INC.

(Exact name of registrant as specified in its charter)

VIRGINIA 54-1821055  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

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12800 TUCKAHOE CREEK PARKWAY, RICHMOND, VIRGINIA 23238  
(Address of principal executive offices) (Zip Code)

(804) 747-0422

(Registrant's telephone number, including area code)

N/A

(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 check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

Yes No

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

Class Outstanding as of June 30, 2015

|                                |             |
|--------------------------------|-------------|
| Common Stock, par value \$0.50 | 208,041,760 |
|--------------------------------|-------------|

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## CARMAX, INC. AND SUBSIDIARIES

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## CARMAX, INC. AND SUBSIDIARIES

## Consolidated Statements of Earnings

(Unaudited)

| (In thousands except per share data)         | Three Months Ended May 31 |              |                   |              |
|--|---------------------------|--------------|-------------------|--------------|
|  | 2015                      | % (1)        | 2014              | % (1)        |
| <b>SALES AND OPERATING REVENUES:</b>         |                           |              |                   |              |
| Used vehicle sales                           | \$ 3,292,658              | 82.0         | \$ 3,060,341      | 81.6         |
| New vehicle sales                            | 60,048                    | 1.5          | 69,789            | 1.9          |
| Wholesale vehicle sales                      | 576,625                   | 14.4         | 545,245           | 14.5         |
| Other sales and revenues                     | 85,557                    | 2.1          | 74,821            | 2.0          |
| <b>NET SALES AND OPERATING REVENUES</b>      | <b>4,014,888</b>          | <b>100.0</b> | <b>3,750,196</b>  | <b>100.0</b> |
| Cost of sales                                | 3,471,094                 | 86.5         | 3,248,465         | 86.6         |
| <b>GROSS PROFIT</b>                          | <b>543,794</b>            | <b>13.5</b>  | <b>501,731</b>    | <b>13.4</b>  |
| <b>CARMAX AUTO FINANCE INCOME</b>            | <b>109,108</b>            | <b>2.7</b>   | <b>94,615</b>     | <b>2.5</b>   |
| Selling, general and administrative expenses | 349,779                   | 8.7          | 313,446           | 8.4          |
| Interest expense                             | 7,103                     | 0.2          | 7,601             | 0.2          |
| Other expense                                | 41                        |              | 277               |              |
| Earnings before income taxes                 | 295,979                   | 7.4          | 275,022           | 7.3          |
| Income tax provision                         | 114,005                   | 2.8          | 105,369           | 2.8          |
| <b>NET EARNINGS</b>                          | <b>\$ 181,974</b>         | <b>4.5</b>   | <b>\$ 169,653</b> | <b>4.5</b>   |
| <b>WEIGHTED AVERAGE COMMON SHARES:</b>       |                           |              |                   |              |
| Basic  | 208,698                   |              | 220,268           |              |
| Diluted                                      | 211,652                   |              | 223,632           |              |
| <b>NET EARNINGS PER SHARE:</b>               |                           |              |                   |              |
| Basic  | \$ 0.87                   |              | \$ 0.77           |              |

|         |         |         |
|---------|---------|---------|
| Diluted | \$ 0.86 | \$ 0.76 |
|---------|---------|---------|

(1)Percents are calculated as a percentage of net sales and operating revenues and may not total due to rounding.

See accompanying notes to consolidated financial statements.

## CARMAX, INC. AND SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

(Unaudited)

| (In thousands)                                   | Three Months Ended |            |
|--|--------------------|------------|
|  | May 31             |            |
|  | 2015               | 2014       |
| NET EARNINGS                                     | \$ 181,974         | \$ 169,653 |
| Other comprehensive (loss) income, net of taxes: |                    |            |
| Net change in retirement benefit plan            |                    |            |
| unrecognized actuarial losses                    | 306                | 213        |
| Net change in cash flow hedge                    |                    |            |
| unrecognized losses                              | (1,373)            | 282        |
| Other comprehensive (loss) income, net of taxes  | (1,067)            | 495        |
| TOTAL COMPREHENSIVE INCOME                       | \$ 180,907         | \$ 170,148 |

See accompanying notes to consolidated financial statements.



## CARMAX, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

|  | (Unaudited)          |                      |
|--|----------------------|----------------------|
|  | As of May 31         | As of February       |
| (In thousands except share data)                                 | 2015                 | 2015                 |
| <b>ASSETS</b>  |                      |                      |
| <b>CURRENT ASSETS:</b>   |                      |                      |
| Cash and cash equivalents  | \$ 351,698           | \$ 27,606            |
| Restricted cash from collections on auto loan receivables        | 328,054              | 294,122              |
| Accounts receivable, net   | 103,663              | 137,690              |
| Inventory  | 1,844,077            | 2,086,874            |
| Deferred income taxes  | 9,245                | 8,100                |
| Other current assets   | 29,088               | 44,646               |
| <b>TOTAL CURRENT ASSETS</b>                                      | <b>2,665,825</b>     | <b>2,599,038</b>     |
| Auto loan receivables, net                                       | 8,812,883            | 8,435,504            |
| Property and equipment, net                                      | 1,896,348            | 1,862,538            |
| Deferred income taxes  | 156,726              | 167,638              |
| Other assets   | 138,895              | 133,483              |
| <b>TOTAL ASSETS</b>  | <b>\$ 13,670,677</b> | <b>\$ 13,198,201</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                      |                      |                      |
| <b>CURRENT LIABILITIES:</b>                                      |                      |                      |
| Accounts payable   | \$ 446,453           | \$ 454,810           |
| Accrued expenses and other current liabilities                   | 184,277              | 250,307              |
| Accrued income taxes   | 59,089               | 1,554                |
| Short-term debt  | 781                  | 785                  |
| Current portion of long-term debt                                |                      | 10,000               |
| Current portion of finance and capital lease obligations         | 21,623               | 21,554               |
| Current portion of non-recourse notes payable                    | 287,350              | 258,163              |
| <b>TOTAL CURRENT LIABILITIES</b>                                 | <b>999,573</b>       | <b>997,173</b>       |
| Long-term debt, excluding current portion                        | 300,000              | 300,000              |
| Finance and capital lease obligations, excluding current portion | 301,480              | 306,284              |
| Non-recourse notes payable, excluding current portion            | 8,574,773            | 8,212,466            |
| Other liabilities  | 220,185              | 225,493              |
| <b>TOTAL LIABILITIES</b>   | <b>10,396,011</b>    | <b>10,041,416</b>    |
| Commitments and contingent liabilities                           |                      |                      |
| <b>SHAREHOLDERS' EQUITY:</b>                                     |                      |                      |
| Common stock, \$0.50 par value; 350,000,000 shares authorized;   |                      |                      |

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|   |               |               |
|---|---------------|---------------|
| 208,682,123 and 208,869,688 shares issued and outstanding<br>as of May 31, 2015 and February 28, 2015, respectively | 104,341       | 104,435       |
| Capital in excess of par value  | 1,170,030     | 1,123,520     |
| Accumulated other comprehensive loss  | (66,458)      | (65,391)      |
| Retained earnings   | 2,066,753     | 1,994,221     |
| TOTAL SHAREHOLDERS' EQUITY  | 3,274,666     | 3,156,785     |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY  | \$ 13,670,677 | \$ 13,198,201 |

See accompanying notes to consolidated financial statements.

## CARMAX, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(Unaudited)

| (In thousands)  | Three Months Ended May 31 |                  |
|---|---------------------------|------------------|
|   | 2015                      | 2014             |
| <b>OPERATING ACTIVITIES:</b>  |                           |                  |
| Net earnings  | \$ 181,974                | \$ 169,653       |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating activities: |                           |                  |
| Depreciation and amortization   | 32,066                    | 27,343           |
| Share-based compensation expense  | 23,409                    | 15,388           |
| Provision for loan losses   | 13,598                    | 15,847           |
| Provision for cancellation reserves   | 20,330                    | 21,118           |
| Deferred income tax provision   | 10,475                    | 771              |
| Loss on disposition of assets and other   | 77                        | – 424            |
| Net decrease (increase) in:   |                           |                  |
| Accounts receivable, net  | 34,027                    | (17,887)         |
| Inventory   | 242,797                   | (40,376)         |
| Other current assets  | 14,423                    | 664              |
| Auto loan receivables, net  | (390,977)                 | (415,664)        |
| Other assets  | 57                        | 3,467            |
| Net (decrease) increase in:   |                           |                  |
| Accounts payable, accrued expenses and other current liabilities and accrued income taxes     | (31,043)                  | 40,424           |
| Other liabilities   | (33,659)                  | (30,252)         |
| <b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>                                    | <b>117,554</b>            | <b>(209,080)</b> |
| <b>INVESTING ACTIVITIES:</b>  |                           |                  |
| Capital expenditures  | (59,437)                  | (53,709)         |
| Proceeds from sales of assets   | 1,419                     |                  |
| Increase in restricted cash from collections on auto loan receivables                         | (33,932)                  | (31,354)         |
| Increase in restricted cash in reserve accounts   | (2,972)                   | (3,259)          |
| Release of restricted cash from reserve accounts  | 1,633                     | 4                |
| Sales (purchases) of money market securities, net   | 82                        | (3,035)          |
| Purchases of trading securities   | (3,942)                   | (2,798)          |
| Sales of trading securities   | 72                        | 32               |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>  | <b>(97,077)</b>           | <b>(94,119)</b>  |
| <b>FINANCING ACTIVITIES:</b>  |                           |                  |
| (Decrease) increase in short-term debt, net   | (4)                       | 660              |
| Proceeds from revolving line of credit and long-term debt                                     | 20,000                    |                  |
| Payments on revolving line of credit and long-term debt                                       | (30,000)                  |                  |
| Payments on finance and capital lease obligations   | (4,652)                   | (4,204)          |
| Issuances of non-recourse notes payable   | 3,047,805                 | 1,897,000        |

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|   |                   |                   |
|---|-------------------|-------------------|
| Payments on non-recourse notes payable                    | (2,656,311)       | (1,518,469)       |
| Repurchase and retirement of common stock                 | (117,628)         | (171,924)         |
| Equity issuances, net                                     | 17,725            | 120               |
| Excess tax benefits from share-based payment arrangements | 26,680            | 4,306             |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>          | <b>303,615</b>    | <b>207,489</b>    |
| Increase (decrease) in cash and cash equivalents          | 324,092           | (95,710)          |
| Cash and cash equivalents at beginning of year            | 27,606            | 627,901           |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>         | <b>\$ 351,698</b> | <b>\$ 532,191</b> |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>  |                   |                   |
| Cash paid for interest                                    | \$ 9,976          | \$ 7,642          |
| Cash paid for income taxes                                | \$ 813            | \$ 5,802          |
| Non-cash investing and financing activities:              |                   |                   |
| Increase in accrued capital expenditures                  | \$ 5,820          | \$ 10,338         |
| Increase in finance and capital lease obligations         | \$                | \$ 5,297          |

See accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

1. Background

CarMax, Inc. (“we,” “our,” “us,” “CarMax” and “the company”), including its wholly owned subsidiaries, is the largest retailer of used vehicles in the United States. We operate in two reportable segments: CarMax Sales Operations and CarMax Auto Finance (“CAF”). Our CarMax Sales Operations segment consists of all aspects of our auto merchandising and service operations, excluding financing provided by CAF. Our CAF segment consists solely of our own finance operation that provides vehicle financing through CarMax stores.

We seek to deliver an unrivaled customer experience by offering a broad selection of high quality used vehicles and related products and services at low, no-haggle prices using a customer-friendly sales process in an attractive, modern sales facility. We provide customers with a full range of related products and services, including the appraisal and purchase of vehicles directly from consumers; the financing of vehicle purchases through CAF and third-party financing providers; the sale of extended protection plan (“EPP”) products, which include extended service plans (“ESP”) and guaranteed asset protection (“GAP”); and vehicle repair service. Vehicles purchased through the appraisal process that do not meet our retail standards are sold to licensed dealers through on-site wholesale auctions. At select locations we also sell new vehicles under franchise agreements.

2. Accounting Policies

**Basis of Presentation and Use of Estimates.** The accompanying interim unaudited consolidated financial statements include the accounts of CarMax and our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. These consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, such interim consolidated financial statements reflect all normal recurring adjustments considered necessary to present fairly the financial position and the results of operations and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full fiscal year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended February 28, 2015.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to the current year's presentation. Amounts and percentages may not total due to rounding.

**Cash and Cash Equivalents.** Cash equivalents of \$318.5 million as of May 31, 2015, and \$48,000 as of February 28, 2015, consisted of highly liquid investments with original maturities of three months or less.

**Restricted Cash from Collections on Auto Loan Receivables.** Cash equivalents totaling \$328.1 million as of May 31, 2015, and \$294.1 million as of February 28, 2015, consisted of collections of principal, interest and fee payments on securitized auto loan receivables that are restricted for payment to the securitization investors pursuant to the applicable securitization agreements.

**Securitizations.** We maintain a revolving securitization program composed of two warehouse facilities ("warehouse facilities") that we use to fund auto loan receivables originated by CAF until we elect to fund them through a term securitization or alternative funding arrangement. We sell the auto loan receivables to one of two wholly owned, bankruptcy-remote, special purpose entities that transfer an undivided percentage ownership interest in the receivables, but not the receivables themselves, to entities formed by third-party investors. These entities issue asset-backed commercial paper or utilize other funding sources supported by the transferred receivables, and the proceeds are used to finance the securitized receivables.

We typically use term securitizations to provide long-term funding for most of the auto loan receivables initially securitized through the warehouse facilities. In these transactions, a pool of auto loan receivables is sold to a bankruptcy-remote, special purpose entity that, in turn, transfers the receivables to a special purpose securitization trust. The

securitization trust issues asset-backed securities, secured or otherwise supported by the transferred receivables, and the proceeds from the sale of the asset-backed securities are used to finance the securitized receivables.

We are required to evaluate term securitization trusts for consolidation. In our capacity as servicer, we have the power to direct the activities of the trusts that most significantly impact the economic performance of the trusts. In addition, we have the obligation to absorb losses (subject to limitations) and the rights to receive any returns of the trusts, which could be significant. Accordingly, we are the primary beneficiary of the trusts and are required to consolidate them.

We recognize transfers of auto loan receivables into the warehouse facilities and term securitizations (“securitization vehicles”) as secured borrowings, which result in recording the auto loan receivables and the related non-recourse notes payable on our consolidated balance sheets.

The securitized receivables can only be used as collateral to settle obligations of the securitization vehicles. The securitization vehicles and investors have no recourse to our assets beyond the securitized receivables, the amounts on deposit in reserve accounts and the restricted cash from collections on auto loan receivables. We have not provided financial or other support to the securitization vehicles that was not previously contractually required, and there are no additional arrangements, guarantees or other commitments that could require us to provide financial support to the securitization vehicles.

See Notes 4 and 10 for additional information on auto loan receivables and non-recourse notes payable.

**Auto Loan Receivables, Net.** Auto loan receivables include amounts due from customers related to retail vehicle sales financed through CAF. The receivables are presented net of an allowance for estimated loan losses. The allowance for loan losses represents an estimate of the amount of net losses inherent in our portfolio of managed receivables as of the applicable reporting date and anticipated to occur during the following 12 months. The allowance is primarily based on the credit quality of the underlying receivables, historical loss trends and forecasted forward loss curves. We also take into account recent trends in delinquencies, losses, recovery rates and the economic environment. The provision for loan losses is the periodic expense of maintaining an adequate allowance.

An account is considered delinquent when the related customer fails to make a substantial portion of a scheduled payment on or before the due date. In general, accounts are charged-off on the last business day of the month during which the earliest of the following occurs: the receivable is 120 days or more delinquent as of the last business day of the month, the related vehicle is repossessed and liquidated, or the receivable is otherwise deemed uncollectible. For purposes of determining impairment, auto loans are evaluated collectively, as they represent a large group of smaller-balance homogeneous loans, and therefore, are not individually evaluated for impairment. See Note 4 for additional information on auto loan receivables.

Interest income and expenses related to auto loans are included in CAF income. Interest income on auto loan receivables is recognized when earned based on contractual loan terms. All loans continue to accrue interest until repayment or charge off. Direct costs associated with loan originations are not considered material, and thus, are expensed as incurred. See Note 3 for additional information on CAF income.

**Property and Equipment.** Property and equipment is stated at cost less accumulated depreciation and amortization of \$849.8 million and \$822.7 million as of May 31, 2015 and February 28, 2015, respectively.

**Other Assets.** Other assets includes amounts classified as restricted cash on deposit in reserve accounts and restricted investments. The restricted cash on deposit in reserve accounts is for the benefit of holders of non-recourse notes payable, and these funds are not expected to be available to the company or its creditors. In the event that the cash generated by the securitized receivables in a given period was insufficient to pay the interest, principal and other required payments, the balances on deposit in the reserve accounts would be used to pay those amounts. Restricted cash on deposit in reserve accounts is invested in money market securities and was \$44.1 million as of May 31, 2015, and \$42.7 million as of February 28, 2015.

Restricted investments includes money market securities primarily held to satisfy certain insurance program requirements, as well as mutual funds held in a rabbi trust established to fund informally our executive deferred compensation plan. Restricted investments totaled \$56.6 million as of May 31, 2015, and \$52.4 million as of February 28, 2015.

**Revenue Recognition.** We recognize revenue when the earnings process is complete, generally either at the time of sale to a customer or upon delivery to a customer. As part of our customer service strategy, we guarantee the retail vehicles we



sell with a 5 day, money-back guarantee. We record a reserve for estimated returns based on historical experience and trends.

We also sell ESPs and GAP products on behalf of unrelated third parties, who are the primary obligors, to customers who purchase a vehicle. The ESPs we currently offer on all used vehicles provide coverage of up to 60 months (subject to mileage limitations), while GAP covers the customer for the term of their finance contract. We recognize commission revenue at the time of sale, net of a reserve for estimated contract cancellations. Periodically, we may receive additional commissions based upon the level of underwriting profits of the third parties who administer the products. These additional commissions are recognized as revenue when received. The reserve for cancellations is evaluated for each product, and is based on forecasted forward cancellation curves utilizing historical experience, recent trends and credit mix of the customer base. Our risk related to contract cancellations is limited to the commissions that we receive. Cancellations fluctuate depending on the volume of EPP sales, customer financing default or prepayment rates, and shifts in customer behavior, including those related to changes in the coverage or term of the product. The current portion of estimated cancellation reserves is recognized as a component of other current liabilities with the remaining amount recognized in other liabilities. See Note 7 for additional information on cancellation reserves.

Customers applying for financing who are not approved or are conditionally approved by CAF are generally evaluated by third-party finance providers. These providers generally either pay us or are paid a fixed, pre-negotiated fee per contract. We recognize these fees at the time of sale.

We collect sales taxes and other taxes from customers on behalf of governmental authorities at the time of sale. These taxes are accounted for on a net basis and are not included in net sales and operating revenues or cost of sales.

**Derivative Instruments and Hedging Activities.** We enter into derivative instruments to manage exposures that arise from business activities and economic conditions that result in the future known receipt or payment of uncertain cash amounts, the values of which are impacted by interest rates. We recognize the derivatives at fair value as either current assets or current liabilities on the consolidated balance sheets, and where applicable, such contracts covered by master netting agreements are reported net. Gross positive fair values are netted with gross negative fair values by counterparty. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether we have elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. We may enter into derivative contracts that are intended to economically hedge certain risks, even though hedge accounting may not apply or we do not elect to apply hedge accounting. See Note 5 for additional information on derivative instruments and hedging activities.

**Recent Accounting Pronouncements.**

Effective in the Current Period. In April 2014, the Financial Accounting Standards Board ("FASB") issued an accounting pronouncement (FASB ASU 2014-8) related to discontinued operations (FASB ASC Topic 205). The standard raises the threshold for disposals to qualify as a discontinued operation by focusing on strategic shifts that have or will have a major effect on an entity's operations and financial results. The standard also requires additional disclosures for discontinued operations and new disclosures for individually material disposal transactions that do not meet the definition of discontinued operations. We adopted this pronouncement for our fiscal year beginning March 1, 2015, and there was no effect on our consolidated financial statements.

Effective in Future Periods. In May 2015, the FASB issued an accounting pronouncement (FASB ASU 2015-7) which eliminates the requirement for entities to categorize within the fair value hierarchy investments for which fair values are measured at net asset value ("NAV") per share (FASB ASC Subtopic 820-10). This standard also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the NAV per share practical expedient, instead limiting disclosures to investments for which the entity has elected the expedient. This pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015, and retrospective adoption is required. We will adopt this pronouncement for our fiscal year beginning March 1, 2016. We do not expect this pronouncement to have a material effect on our consolidated financial statements.

### 3.CarMax Auto Finance

CAF provides financing to qualified retail customers purchasing vehicles at CarMax stores. CAF provides us the opportunity to capture additional profits, cash flows and sales while managing our reliance on third-party finance sources. Management regularly analyzes CAF's operating results by assessing profitability, the performance of the auto loan receivables including trends in credit losses and delinquencies, and CAF direct expenses. This information is used to assess CAF's performance and make operating decisions including resource allocation.

We typically use securitizations to fund loans originated by CAF, as discussed in Note 2. CAF income primarily reflects the interest and fee income generated by the auto loan receivables less the interest expense associated with the debt issued to fund these receivables, a provision for estimated loan losses and direct CAF expenses.

CAF income does not include any allocation of indirect costs. Although CAF benefits from certain indirect overhead expenditures, we have not allocated indirect costs to CAF to avoid making subjective allocation decisions. Examples of indirect costs not allocated to CAF include retail store expenses and corporate expenses such as human resources, administrative services, marketing, information systems, accounting, legal, treasury and executive payroll. In addition, except for auto loan receivables, which are disclosed in Note 4, CAF assets are not separately reported nor do we allocate assets to CAF because such allocation would not be useful to management in making operating decisions.

#### Components of CAF Income

| (In millions)   | Three Months Ended May 31 |       |            |       |
|---|---------------------------|-------|------------|-------|
|   | 2015                      | % (1) | 2014       | % (1) |
| Interest margin:                                      |                           |       |            |       |
| Interest and fee income                               | \$ 164.9                  | 7.6   | \$ 147.0   | 8.0   |
| Interest expense                                      | (28.1)                    | (1.3) | (23.1)     | (1.2) |
| Total interest margin                                 | 136.8                     | 6.3   | 123.9      | 6.7   |
| Provision for loan losses                             | (13.6)                    | (0.6) | (15.8)     | (0.9) |
| Total interest margin after provision for loan losses | 123.2                     | 5.7   | 108.1      | 5.8   |
| Direct expenses:                                      |                           |       |            |       |
| Payroll and fringe benefit expense                    | (6.8)                     | (0.3) | (6.2)      | (0.3) |
| Other direct expenses                                 | (7.3)                     | (0.4) | (7.3)      | (0.4) |
| Total direct expenses                                 | (14.1)                    | (0.7) | (13.5)     | (0.7) |
| CarMax Auto Finance income                            | \$ 109.1                  | 5.0   | \$ 94.6    | 5.1   |
| Total average managed receivables                     | \$ 8,664.6                |       | \$ 7,390.1 |       |

(1) Annualized percentage of total average managed receivables.

#### 4. Auto Loan Receivables

Auto loan receivables include amounts due from customers related to retail vehicle sales financed through CAF and are presented net of an allowance for estimated loan losses. We generally use warehouse facilities to fund auto loan receivables originated by CAF until we elect to fund them through a term securitization or alternative funding arrangement. The majority of the auto loan receivables serve as collateral for the related non-recourse notes payable of \$8.86 billion as of May 31, 2015 and \$8.47 billion as of February 28, 2015. See Notes 2 and 10 for additional information on securitizations and non-recourse notes payable.

## Auto Loan Receivables, Net

|                                  | As of May<br>31<br>2015 | As of<br>February 28<br>2015 |
|----------------------------------|-------------------------|------------------------------|
| (In millions)                    |                         |                              |
| Warehouse facilities             | \$ 1,089.0              | \$ 986.0                     |
| Term securitizations             | 7,485.8                 | 7,226.5                      |
| Other receivables (1)            | 287.8                   | 246.2                        |
| Total ending managed receivables | 8,862.6                 | 8,458.7                      |
| Accrued interest and fees        | 35.1                    | 31.2                         |
| Other                            | (1.1)                   | 27.3                         |
| Less allowance for loan losses   | (83.7)                  | (81.7)                       |
| Auto loan receivables, net       | \$ 8,812.9              | \$ 8,435.5                   |

(1) Other receivables includes receivables not funded through the warehouse facilities or term securitizations.

**Credit Quality.** When customers apply for financing, CAF's proprietary scoring models rely on the customers' credit history and certain application information to evaluate and rank their risk. We obtain credit histories and other credit data that includes information such as number, age, type of and payment history for prior or existing credit accounts. The application information that is used includes income, collateral value and down payment. The scoring models yield credit grades that represent the relative likelihood of repayment. Customers assigned a grade of "A" are determined to have the highest probability of repayment, and customers assigned a lower grade are determined to have a lower probability of repayment. For loans that are approved, the credit grade influences the terms of the agreement, such as the required loan-to-value ratio and interest rate.

CAF uses a combination of the initial credit grades and historical performance to monitor the credit quality of the auto loan receivables on an ongoing basis. We validate the accuracy of the scoring models periodically. Loan performance is reviewed on a recurring basis to identify whether the assigned grades adequately reflect the customers' likelihood of repayment.

## Ending Managed Receivables by Major Credit Grade

|                                  | As of May 31 |       | As of February 28 |       |
|----------------------------------|--------------|-------|-------------------|-------|
| (In millions)                    | 2015 (1)     | % (2) | 2015 (1)          | % (2) |
| A                                | \$ 4,301.7   | 48.5  | \$ 4,135.6        | 48.9  |
| B                                | 3,201.2      | 36.1  | 3,055.3           | 36.1  |
| C and other                      | 1,359.7      | 15.4  | 1,267.8           | 15.0  |
| Total ending managed receivables | \$ 8,862.6   | 100.0 | \$ 8,458.7        | 100.0 |

(1)Classified based on credit grade assigned when customers were initially approved for financing.

(2)Percent of total ending managed receivables.

## Allowance for Loan Losses

| (In millions)                   | As of May 31 |       |         |       |
|---------------------------------|--------------|-------|---------|-------|
|                                 | 2015         | % (1) | 2014    | % (1) |
| Balance as of beginning of year | \$ 81.7      | 0.97  | \$ 69.9 | 0.97  |
| Charge-offs                     | (34.3)       |       | (32.0)  |       |
| Recoveries                      | 22.7         |       | 21.7    |       |
| Provision for loan losses       | 13.6         |       | 15.8    |       |
| Balance as of end of period     | \$ 83.7      | 0.94  | \$ 75.4 | 1.00  |

(1)Percent of total ending managed receivables.

The allowance for loan losses represents an estimate of the amount of net losses inherent in our portfolio of managed receivables as of the applicable reporting date and anticipated to occur during the following 12 months. The allowance is primarily based on the credit quality of the underlying receivables, historical loss trends and forecasted forward loss curves. We also take into account recent trends in delinquencies and losses, recovery rates and the economic environment. The provision for loan losses is the periodic expense of maintaining an adequate allowance.

## Past Due Receivables

| (In millions)                    | As of May 31 |       | As of February 28 |       |
|----------------------------------|--------------|-------|-------------------|-------|
|                                  | 2015         | % (1) | 2015              | % (1) |
| Total ending managed receivables | \$ 8,862.6   | 100.0 | \$ 8,458.7        | 100.0 |
| Delinquent loans:                |              |       |                   |       |
| 31-60 days past due              | \$ 161.1     | 1.8   | \$ 152.1          | 1.8   |
| 61-90 days past due              | 56.1         | 0.6   | 52.5              | 0.6   |
| Greater than 90 days past due    | 17.2         | 0.2   | 16.8              | 0.2   |
| Total past due                   | \$ 234.4     | 2.6   | \$ 221.4          | 2.6   |

(1)Percent of total ending managed receivables.

## 5. Derivative Instruments and Hedging Activities

**Risk Management Objective of Using Derivatives.** We use derivatives to manage certain risks arising from both our business operations and economic conditions, particularly with regard to future issuances of fixed-rate debt and

existing issuances of floating-rate debt. Primary exposures include LIBOR and other rates used as benchmarks in our securitizations and other debt financing. We enter into derivative instruments to manage exposures related to the future known receipt or payment of uncertain cash amounts, the values of which are impacted by interest rates. Our derivative instruments are used to manage (i) differences in the amount of our known or expected cash receipts and our known or expected cash payments principally related to the funding of our auto loan receivables, and (ii) exposure to variable interest rates associated with our term loan, as further discussed in Note 10.

We do not anticipate significant market risk from derivatives as they are predominantly used to match funding costs to the use of the funding. However, disruptions in the credit or interest rate markets could impact the effectiveness of our hedging strategies.

Credit risk is the exposure to nonperformance of another party to an agreement. We mitigate credit risk on our derivative transactions by dealing with highly rated bank counterparties.

Designated Cash Flow Hedges – Securitizations. Our objectives in using interest rate derivatives in conjunction with our securitization program are to add stability to CAF's interest expense, to manage our exposure to interest rate movements and to better match funding costs to the interest received on the receivables being securitized.



To accomplish these objectives, we primarily use interest rate swaps that involve the receipt of variable amounts from a counterparty in exchange for our making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. These interest rate swaps are designated as cash flow hedges of forecasted interest payments in anticipation of permanent funding in the term securitization market.

For these derivatives, the effective portion of changes in the fair value is initially recorded in accumulated other comprehensive loss (“AOCL”). These amounts are subsequently reclassified into CAF income in the period that the hedged forecasted transaction affects earnings, which occurs as interest expense is recognized on those future issuances of fixed-rate debt. The ineffective portion of the change in fair value of the derivatives is recognized directly in CAF income. During the next 12 months, we estimate that an additional \$10.1 million will be reclassified from AOCL as a decrease to CAF income.

In addition, we have issued floating rate notes in connection with our term securitizations. To manage our exposure to interest rate movements, we have entered into interest rate swaps that involve the receipt of variable amounts from a counterparty in exchange for making fixed-rate payments over the estimated life of the note. These derivatives are designated as cash flow hedges. The ineffective portion of the change in fair value of the derivatives is recognized directly in CAF income.

These hedges were effective in the first quarter of fiscal 2016 and changes in the fair value were recorded in AOCL.

Designated Cash Flow Hedge – Other Debt. Our objective in using an interest rate derivative for our term loan is to manage our exposure to interest rate movements. To accomplish this objective, we use an interest rate swap that involves the receipt of variable amounts from a counterparty in exchange for our making fixed-rate payments over the life of the loan without exchange of the underlying notional amount. This derivative instrument is designated and qualifies as a cash flow hedge, where the effective portion of the change in the fair value is recorded in AOCL. The ineffective portion of the change in fair value is recognized in current income. These hedges were effective in the first quarter of fiscal 2016.

As of May 31, 2015 and February 28, 2015, we had interest rate swaps outstanding with a combined notional amount of \$1.68 billion and \$1.40 billion, respectively, that were designated as cash flow hedges of interest rate risk.

As of May 31, 2015 and February 28, 2015, all derivatives were designated as hedges for accounting purposes.

#### Fair Values of Derivative Instruments

| (In thousands)                               | As of May 31,<br>2015 |             | As of February 28,<br>2015 |             |
|--|-----------------------|-------------|----------------------------|-------------|
|  | Assets                | Liabilities | Assets                     | Liabilities |
| Derivatives designated as accounting hedges: |                       |             |                            |             |
| Interest rate swaps (1)                      | \$ 66                 | \$          | \$ 1,201                   | \$          |
| Interest rate swaps (2)                      |                       | (2,633)     |                            | (1,064)     |
| Total  | \$ 66                 | \$ (2,633)  | \$ 1,201                   | \$ (1,064)  |

(1)Reported in other current assets on the consolidated balance sheets.

(2)Reported in accounts payable on the consolidated balance sheets.

#### Effect of Derivative Instruments on Comprehensive Income

| (In thousands)                                  | Three Months Ended<br>May 31 |            |
|---|------------------------------|------------|
|   | 2015                         | 2014       |
| Derivatives designated as accounting hedges:    |                              |            |
| Loss recognized in AOCL (1)                     | \$ (4,316)                   | \$ (1,798) |
| Loss reclassified from AOCL into CAF income (1) | \$ (2,051)                   | \$ (2,263) |

(1)Represents the effective portion.

## 6. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market or, if none exists, the most advantageous market, for the specific asset or liability at the measurement date (referred to as the “exit price”). The fair value should be based on assumptions that market participants would use, including a consideration of nonperformance risk.

We assess the inputs used to measure fair value using the three-tier hierarchy. The hierarchy indicates the extent to which inputs used in measuring fair value are observable in the market.

Level 1 Inputs include unadjusted quoted prices in active markets for identical assets or liabilities that we can access at the measurement date.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets in active markets, quoted prices from identical or similar assets in inactive markets and observable inputs such as interest rates and yield curves.

Level 3 Inputs that are significant to the measurement that are not observable in the market and include management's judgments about the assumptions market participants would use in pricing the asset or liability (including assumptions about risk).

Our fair value processes include controls that are designed to ensure that fair values are appropriate. Such controls include model validation, review of key model inputs, analysis of period-over-period fluctuations and reviews by senior management.

### Valuation Methodologies

**Money Market Securities.** Money market securities are cash equivalents, which are included in cash and cash equivalents, restricted cash from collections on auto loan receivables or other assets. They consist of highly liquid investments with original maturities of three months or less. We use quoted market prices for identical assets to measure fair value. Therefore, all money market securities are classified as Level 1.

**Mutual Fund Investments.** Mutual fund investments consist of publicly traded mutual funds that primarily include diversified investments in large-, mid- and small-cap domestic and international companies. The investments, which are included in other assets, are held in a rabbi trust established to fund informally our executive deferred compensation plan. We use quoted active market prices for identical assets to measure fair value. Therefore, all mutual fund investments are classified as Level 1.

**Derivative Instruments.** The fair values of our derivative instruments are included in either other current assets or accounts payable. As described in Note 5, as part of our risk management strategy, we utilize derivative instruments to manage differences in the amount of our known or expected cash receipts and our known or expected cash payments principally related to the funding of our auto loan receivables as well as to manage exposure to variable interest rates on our term loan. Our derivatives are not exchange-traded and are over-the-counter customized derivative instruments. All of our derivative exposures are with highly rated bank counterparties.

We measure derivative fair values assuming that the unit of account is an individual derivative instrument and that derivatives are sold or transferred on a stand-alone basis. We estimate the fair value of our derivatives using quotes determined by the derivative counterparties and third-party valuation services. Quotes from third-party valuation services and quotes received from bank counterparties project future cash flows and discount the future amounts to a present value using market-based expectations for interest rates and the contractual terms of the derivative instruments. The models do not require significant judgment and model inputs can typically be observed in a liquid market; however, because the models include inputs other than quoted prices in active markets, all derivatives are classified as Level 2.

Our derivative fair value measurements consider assumptions about counterparty and our own nonperformance risk. We monitor counterparty and our own nonperformance risk and, in the event that we determine that a party is unlikely to perform under terms of the contract, we would adjust the derivative fair value to reflect the nonperformance risk.

## Items Measured at Fair Value on a Recurring Basis

| (In thousands)                        | As of May 31, 2015 |            | Total      |       |   |
|---------------------------------------|--------------------|------------|------------|-------|---|
|                                       | Level 1            | Level 2    |            |       |   |
| Assets:                               |                    |            |            |       |   |
| Money market securities               | \$ 733,700         | \$         | \$ 733,700 |       |   |
| Mutual fund investments               | 13,467             |            | 13,467     |       |   |
| Derivative instruments                |                    | 66         | 66         |       |   |
| Total assets at fair value            | \$ 747,167         | \$ 66      | \$ 747,233 |       |   |
| Percent of total assets at fair value | 100.0              | %          | %          | 100.0 | % |
| Percent of total assets               | 5.5                | %          | %          | 5.5   | % |
| Liabilities:                          |                    |            |            |       |   |
| Derivative instruments                | \$                 | \$ (2,633) | \$ (2,633) |       |   |
| Total liabilities at fair value       | \$                 | \$ (2,633) | \$ (2,633) |       |   |
| Percent of total liabilities          |                    | %          | %          |       | % |

| (In thousands)                        | As of February 28, 2015 |            | Total      |     |       |
|---------------------------------------|-------------------------|------------|------------|-----|-------|
|                                       | Level 1                 | Level 2    |            |     |       |
| Assets:                               |                         |            |            |     |       |
| Money market securities               | \$ 380,100              | \$         | \$ 380,100 |     |       |
| Mutual fund investments               | 9,242                   |            | 9,242      |     |       |
| Derivative instruments                |                         | 1,201      | 1,201      |     |       |
| Total assets at fair value            | \$ 389,342              | \$ 1,201   | \$ 390,543 |     |       |
| Percent of total assets at fair value | 99.7                    | %          | 0.3        | %   | 100.0 |
| Percent of total assets               | 2.9                     | %          | %          | 3.0 | %     |
| Liabilities:                          |                         |            |            |     |       |
| Derivative instruments                | \$                      | \$ (1,064) | \$ (1,064) |     |       |
| Total liabilities at fair value       | \$                      | \$ (1,064) | \$ (1,064) |     |       |
| Percent of total liabilities          |                         | %          | %          |     | %     |

There were no transfers between Levels 1 and 2 for the period ended May 31, 2015.

## 7.Cancellation Reserves

We recognize commission revenue for EPP products at the time of sale, net of a reserve for estimated contract cancellations. Cancellations of these services may result from early termination by the customer, or default or prepayment on the finance contract. The reserve for cancellations is evaluated for each product, and is based on forecasted forward cancellation curves utilizing historical experience, recent trends and credit mix of the customer base.

## Cancellation Reserves

| (In millions)                      | As of May 31 |         |
|------------------------------------|--------------|---------|
|                                    | 2015         | 2014    |
| Balance as of beginning of year    | \$ 94.4      | \$ 72.5 |
| Cancellations                      | (14.4)       | (12.5)  |
| Provision for future cancellations | 20.3         | 21.1    |
| Balance as of end of period        | \$ 100.3     | \$ 81.1 |

The current portion of estimated cancellation reserves is recognized as a component of other accrued expenses with the remaining amount recognized in other liabilities. As of May 31, 2015 and February 28, 2015, the current portion of cancellation reserves was \$47.9 million and \$44.8 million, respectively.

## 8. Income Taxes

We had \$26.2 million of gross unrecognized tax benefits as of May 31, 2015, and \$25.0 million as of February 28, 2015. There were no significant changes to the gross unrecognized tax benefits as reported for the year ended February 28, 2015, as all activity was related to positions taken on tax returns filed or intended to be filed in the current fiscal year.

## 9. Retirement Plans

Effective December 31, 2008, we froze both of our noncontributory defined benefit plans: our pension plan (the “pension plan”) and our unfunded, nonqualified plan (the “restoration plan”), which restores retirement benefits for certain associates who are affected by Internal Revenue Code limitations on benefits provided under the pension plan. No additional benefits have accrued under these plans since that date. In connection with benefits earned prior to December 31, 2008, we have a continuing obligation to fund the pension plan and will continue to recognize net periodic pension expense for both plans. We use a fiscal year end measurement date for both the pension plan and the restoration plan.

## Components of Net Pension Expense

## Three Months Ended May 31

| (In thousands)                 | Pension Plan |          | Restoration Plan |        | Total    |          |
|--------------------------------|--------------|----------|------------------|--------|----------|----------|
|                                | 2015         | 2014     | 2015             | 2014   | 2015     | 2014     |
| Interest cost                  | \$ 2,168     | \$ 2,008 | \$ 108           | \$ 113 | \$ 2,276 | \$ 2,121 |
| Expected return on plan assets | (2,465)      | (2,267)  |                  |        | (2,465)  | (2,267)  |
| Recognized actuarial loss      | 483          | 340      | 6                |        | 489      | 340      |
| Net pension expense            | \$ 186       | \$ 81    | \$ 114           | \$ 113 | \$ 300   | \$ 194   |

We made no contributions to the pension plan during the three months ended May 31, 2015, and do not anticipate making any contributions during the remainder of fiscal 2016. The expected long-term rate of return on plan assets for the pension plan was 7.75% as of February 28, 2015.



## 10. Debt

| (In thousands)   | As of May 31<br>2015 | As of<br>February 28<br>2015 |
|--|----------------------|------------------------------|
| Short-term revolving credit facility                             | \$ 781               | \$ 785                       |
| Current portion of long-term debt                                |                      | 10,000                       |
| Current portion of finance and capital lease obligations         | 21,623               | 21,554                       |
| Current portion of non-recourse notes payable                    | 287,350              | 258,163                      |
| Total current debt   | 309,754              | 290,502                      |
| Long-term debt   | 300,000              | 300,000                      |
| Finance and capital lease obligations, excluding current portion | 301,480              | 306,284                      |
| Non-recourse notes payable, excluding current portion            | 8,574,773            | 8,212,466                    |
| Total debt, excluding current portion                            | 9,176,253            | 8,818,750                    |
| Total debt   | \$ 9,486,007         | \$ 9,109,252                 |

**Revolving Credit Facility.** We have an unsecured revolving credit facility (the “credit facility”) with a borrowing capacity of \$1.0 billion that expires in August 2016. Borrowings under the credit facility are available for working capital and general corporate purposes. Borrowings accrue interest at variable rates based on LIBOR, the federal funds rate, or the prime rate, depending on the type of borrowing, and we pay a commitment fee on the unused portions of the available funds. Borrowings under the credit facility are either due ‘on demand’ or at maturity depending on the type of borrowing. Borrowings with ‘on demand’ repayment terms are presented as short-term debt while amounts due at maturity are presented as long-term debt with expected repayments within the next fiscal year presented as a component of current portion of long-term debt. As of May 31, 2015, the unused capacity of \$999.2 million was fully available to us.

**Term Loan.** In November 2014, we entered into a \$300 million term loan with total outstanding principal due in November 2017. The term loan accrues interest at variable rates based on the LIBOR rate, the federal funds rate, or the prime rate. As of May 31, 2015, \$300 million remained outstanding and no repayments are scheduled to be made within the next 12 months. Borrowings under the loan are available for working capital and general corporate purposes. We have entered into an interest rate derivative contract to manage our exposure to variable interest rates associated with this term loan.

**Finance and Capital Lease Obligations.** Finance and capital lease obligations relate primarily to stores subject to sale-leaseback transactions that did not qualify for sale accounting, and therefore, are accounted for as financings. The leases were structured at varying interest rates and generally have initial lease terms ranging from 15 to 20 years with payments made monthly. Payments on the leases are recognized as interest expense and a reduction of the obligations. We have not entered into any new sale-leaseback transactions since fiscal 2009.

Non-Recourse Notes Payable. The non-recourse notes payable relate to auto loan receivables funded through term securitizations and our warehouse facilities. The timing of principal payments on the non-recourse notes payable is based on the timing of principal collections and defaults on the securitized auto loan receivables. The current portion of non-recourse notes payable represents principal payments that are due to be distributed in the following period.

As of May 31, 2015, \$7.77 billion of non-recourse notes payable was outstanding related to term securitizations. These notes payable accrue interest predominantly at fixed rates and have scheduled maturities through November 2021, but may mature earlier, depending upon the repayment rate of the underlying auto loan receivables.

As of May 31, 2015, \$1.09 billion of non-recourse notes payable was outstanding related to our warehouse facilities. The combined warehouse facility limit was \$2.3 billion, and unused warehouse capacity totaled \$1.21 billion. Of the combined warehouse facility limit, \$800 million will expire in July 2015 and \$1.5 billion will expire in February 2016. The return requirements of warehouse facility investors could fluctuate significantly depending on market conditions. At renewal, the cost, structure and capacity of the facilities could change. These changes could have a significant impact on our funding costs.

See Notes 2 and 4 for additional information on the related securitized auto loan receivables.

Capitalized Interest. We capitalize interest in connection with the construction of certain facilities. We capitalized interest of \$2.8 million in the first quarter of fiscal 2016; no interest was capitalized in the first quarter of fiscal 2015.

Financial Covenants. The credit facility and term loan agreements contain representations and warranties, conditions and covenants. We must also meet financial covenants in conjunction with certain of the sale-leaseback transactions. Our securitization agreements contain representations and warranties, financial covenants and performance triggers. As of May 31, 2015, we were in compliance with all financial covenants and our securitized receivables were in compliance with the related performance triggers.

## 11. Stock and Stock-Based Incentive Plans

### (A) Share Repurchase Program

In fiscal 2013, our board of directors authorized the repurchase of up to \$800 million of our common stock which was exhausted in fiscal 2015. In fiscal 2015, our board of directors authorized the repurchase of up to an additional \$3 billion of our common stock of which \$1 billion expires on December 31, 2015, and \$2 billion expires on December 31, 2016.

### Common Stock Repurchases

|   | Three Months Ended |            |
|---|--------------------|------------|
|   | May 31             |            |
|   | 2015               | 2014       |
| Number of shares repurchased (in thousands)                 | 1,776.9            | 3,841.9    |
| Average cost per share                                      | \$ 67.49           | \$ 45.33   |
| Available for repurchase, as of end of period (in millions) | \$ 2,249.3         | \$ 1,107.9 |

### (B) Stock Incentive Plans

We maintain long-term incentive plans for management, key employees and the nonemployee members of our board of directors. The plans allow for the granting of equity-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock awards, stock- and cash-settled restricted stock units, stock grants or a combination of awards. To date, we have not awarded any incentive stock options.

The majority of associates who receive share-based compensation awards primarily receive cash-settled restricted stock units. Senior management and other key associates receive awards of nonqualified stock options, stock-settled restricted stock units and stock-settled performance stock units. Nonemployee directors receive awards of nonqualified stock options, stock grants and/or restricted stock awards. Excluding stock grants, all share-based compensation awards, including any associated dividend rights, are subject to forfeiture.

**Nonqualified Stock Options.** Nonqualified stock options are awards that allow the recipient to purchase shares of our common stock at a fixed price. Stock options are granted at an exercise price equal to the fair market value of our common stock on the grant date. The stock options generally vest annually in equal amounts over periods of one to four years. These options expire no later than ten years after the date of the grant.

**Cash-Settled Restricted Stock Units.** Also referred to as restricted stock units, or RSUs, these are restricted stock unit awards that entitle the holder to a cash payment equal to the fair market value of a share of our common stock for each unit granted. Conversion generally occurs at the end of a three-year vesting period. However, the cash payment per RSU will not be greater than 200% or less than 75% of the fair market value of a share of our common stock on the grant date. RSUs are liability awards and do not have voting rights.

**Stock-Settled Market Stock Units.** Also referred to as market stock units, or MSUs, these are restricted stock unit awards with market conditions granted to eligible key associates that are converted into between zero and two shares of common stock for each unit granted. Conversion generally occurs at the end of a three-year vesting period. The conversion ratio is calculated by dividing the average closing price of our stock during the final forty trading days of the three-year vesting period by our stock price on the grant date, with the resulting quotient capped at two. This quotient is then multiplied by the number of MSUs granted to yield the number of shares awarded. MSUs do not have voting rights.

**Stock-Settled Performance Stock Units.** Also referred to as performance stock units, or PSUs, these are restricted stock unit awards with performance conditions granted to eligible key associates that are converted into between zero and two

shares of common stock for each unit granted. Conversion generally occurs at the end of a three-year vesting period. The conversion ratio is based on the company reaching certain target levels set by the board of directors for cumulative three-year earnings before interest and taxes at the end of the three-year vesting period, with the resulting quotient subject to meeting a minimum 25% threshold and capped at 200%. This quotient is then multiplied by the number of PSUs granted to yield the number of shares awarded. PSUs do not have voting rights.

**Restricted Stock Awards.** Restricted stock awards (RSAs) are awards of our common stock that are subject to specified restrictions that generally lapse after a one year period from date of grant. Participants holding restricted stock are entitled to vote on matters submitted to holders of our common stock for a vote. No RSAs were granted during the three months ended May 31, 2015 or 2014. As of May 31, 2015, 22,860 shares of RSAs, which vested in June 2015, remained outstanding. No RSAs were outstanding during the three months ended May 31, 2014. The unrecognized compensation costs related to nonvested RSAs was minimal as of May 31, 2015.

#### (C)Share-Based Compensation

##### Composition of Share-Based Compensation Expense

| (In thousands)  | Three Months Ended |           |
|---|--------------------|-----------|
|   | May 31             |           |
|   | 2015               | 2014      |
| Cost of sales   | \$ 1,048           | \$ 327    |
| CarMax Auto Finance income                            | 157                | 676       |
| Selling, general and administrative expenses          | 22,573             | 14,716    |
| Share-based compensation expense, before income taxes | \$ 23,778          | \$ 15,719 |

##### Composition of Share-Based Compensation Expense – By Grant Type

| (In thousands)  | Three Months Ended |           |
|---|--------------------|-----------|
|   | May 31             |           |
|   | 2015               | 2014      |
| Nonqualified stock options                            | \$ 8,680           | \$ 8,120  |
| Cash-settled restricted stock units                   | 10,873             | 3,147     |
| Stock-settled market stock units                      | 2,896              | 4,121     |
| Stock-settled performance stock units                 | 894                |           |
| Employee stock purchase plan                          | 369                | 331       |
| Restricted stock awards to non-employee directors     | 66                 |           |
| Share-based compensation expense, before income taxes | \$ 23,778          | \$ 15,719 |

We recognize compensation expense for stock options, MSUs, PSUs and RSAs on a straight-line basis (net of estimated forfeitures) over the requisite service period, which is generally the vesting period of the award. The PSU expense is adjusted for any change in management's assessment of the performance target level that is probable of being achieved. The variable expense associated with RSUs is recognized over their vesting period (net of estimated forfeitures) and is calculated based on the volume-weighted average price of our common stock on the last trading day of each reporting period. The total costs for matching contributions for our employee stock purchase plan are included in share-based compensation expense. There were no capitalized share-based compensation costs as of or for the three months ended May 31, 2015 or 2014.

## Stock Option Activity

|   | Number<br>of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (Years) | Weighted<br>Average<br>Aggregate<br>Intrinsic<br>Value |
|---|------------------------|--|---|--|
| (Shares and intrinsic value in thousands) |                        |  |   |  |
| Outstanding as of February 28, 2015       | 7,645                  | \$ 35.59                                 |   |  |
| Options granted                           | 1,374                  | \$ 73.76                                 |   |  |
| Options exercised                         | (1,195)                | \$ 28.71                                 |   |  |
| Outstanding as of May 31, 2015            | 7,824                  | \$ 43.35                                 | 4.8   | \$ 220,377   |
| Exercisable as of May 31, 2015            | 3,925                  | \$ 33.48                                 | 3.7   | \$ 147,433   |

During the three months ended May 31, 2015 and 2014, we granted nonqualified options to purchase 1,374,013 and 2,003,238 shares of common stock, respectively. The total cash received as a result of stock option exercises for the three months ended May 31, 2015 and 2014, was \$34.3 million and \$6.8 million, respectively. We settle stock option exercises with authorized but unissued shares of our common stock. The total intrinsic value of options exercised for the three months ended May 31, 2015 and 2014, was \$53.0 million and \$10.6 million, respectively. We realized related tax benefits of \$21.2 million and \$4.2 million during the three months ended May 31, 2015 and 2014, respectively.

## Outstanding Stock Options

| Range of Exercise Prices | As of May 31, 2015  |                   |                  |                     |
|--------------------------|---------------------|-------------------|------------------|---------------------|
|                          | Options Outstanding | Weighted          |                  | Options Exercisable |
|                          | Number              | Average Remaining | Exercise Average | Weighted Average    |
| (Shares in thousands)    | of                  | Contractual       | Exercise         | Exercise            |
|                          | Shares              | Life (Years)      | Price            | Price               |
| \$ 11.43 - \$ 14.49      | 279                 | 0.8               | \$ 11.99         | 279 \$ 11.99        |
| \$ 19.98 - \$ 31.76      | 2,102               | 3.5               | \$ 30.23         | 1,663 \$ 29.85      |
| \$ 32.69 - \$ 42.68      | 2,135               | 4.2               | \$ 39.19         | 1,460 \$ 37.58      |
| \$ 44.96 - \$ 49.25      | 1,928               | 5.9               | \$ 45.06         | 523 \$ 45.06        |
| \$ 67.82 - \$ 73.76      | 1,380               | 6.8               | \$ 73.73         | \$                  |
| Total                    | 7,824               | 4.8               | \$ 43.35         | 3,925 \$ 33.48      |

For stock options, the fair value of each award is estimated as of the date of grant using a binomial valuation model. In computing the value of the option, the binomial model considers characteristics of fair-value option pricing that are not available for consideration under a closed-form valuation model (for example, the Black-Scholes model),

such as the contractual term of the option, the probability that the option will be exercised prior to the end of its contractual life and the probability of termination or retirement of the option holder. For this reason, we believe that the binomial model provides a fair value that is more representative of actual experience and future expected experience than the value calculated using a closed-form model. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the recipients of share-based awards.

The weighted average fair value per share at the date of grant for options granted during the three months ended May 31, 2015 and 2014, was \$20.61 and \$13.21, respectively. The unrecognized compensation costs related to nonvested options totaled \$50.6 million as of May 31, 2015. These costs are expected to be recognized on a straight-line basis over a weighted average period of 2.7 years.



## Assumptions Used to Estimate Option Values

|                                      | Three Months Ended May 31 |                 |
|--------------------------------------|---------------------------|-----------------|
|                                      | 2015                      | 2014            |
| Dividend yield                       | 0.0 %                     | 0.0 %           |
| Expected volatility factor (1)       | 27.7 % - 31.0 %           | 25.2 % - 32.7 % |
| Weighted average expected volatility | 30.6 %                    | 31.9 %          |
| Risk-free interest rate (2)          | 0.02 % - 1.9 %            | 0.03 % - 2.7 %  |
| Expected term (in years) (3)         | 4.7                       | 4.7             |

(1) Measured using historical daily price changes of our stock for a period corresponding to the term of the options and the implied volatility derived from the market prices of traded options on our stock.

(2) Based on the U.S. Treasury yield curve at the time of grant.

(3) Represents the estimated number of years that options will be outstanding prior to exercise.

## Cash-Settled Restricted Stock Unit Activity

| (Units in thousands)                | Weighted<br>Average<br>Number Grant<br>of Date |            |
|-------------------------------------|--|------------|
|                                     | Units  | Fair Value |
| Outstanding as of February 28, 2015 | 1,530  | \$ 39.81   |
| Stock units granted                 | 418  | \$ 73.76   |
| Stock units vested and converted    | (514)  | \$ 31.77   |
| Stock units cancelled               | (23)   | \$ 44.59   |
| Outstanding as of May 31, 2015      | 1,411  | \$ 52.72   |

During the three months ended May 31, 2015 and 2014, we granted 418,070 and 587,186 RSUs, respectively. The initial fair market value per RSU at the date of grant for the RSUs granted during the three months ended May 31, 2015 and 2014, was \$73.76 and \$44.96, respectively. The RSUs are cash-settled upon vesting. During the three months ended May 31, 2015, we paid \$32.6 million (before payroll tax withholdings) to RSU holders upon the vesting of RSUs, and realized tax benefits of \$13.1 million.

## Expected Cash Settlement Range Upon Restricted Stock Unit Vesting

| (In thousands) | As of May 31, 2015<br>Minimum (1) |
|----------------|-----------------------------------|
|----------------|-----------------------------------|

|                                 |           | Maximum    |
|---------------------------------|-----------|------------|
|                                 |           | (1)        |
| Fiscal 2017                     | \$ 13,946 | \$ 37,189  |
| Fiscal 2018                     | 16,133    | 43,022     |
| Fiscal 2019                     | 19,013    | 50,702     |
| Total expected cash settlements | \$ 49,092 | \$ 130,913 |

(1)Net of estimated forfeitures.

## Stock-Settled Market Stock Unit Activity

|                                     | Number      | Weighted<br>Average<br>Grant<br>Date<br>Fair Value |
|-------------------------------------|-------------|--|
| (Units in thousands)                | of<br>Units |  |
| Outstanding as of February 28, 2015 | 774         | \$ 48.30   |
| Stock units granted                 | 106         | \$ 90.46   |
| Stock units vested and converted    | (319)       | \$ 40.72   |
| Stock units cancelled               |             | \$   |
| Outstanding as of May 31, 2015      | 561         | \$ 60.54   |

During the three months ended May 31, 2015 and 2014, we granted 105,529 and 245,190 MSUs, respectively. The weighted average fair value per MSU at the date of grant during the three months ended May 31, 2015 and 2014, was \$90.46 and \$55.37, respectively. The fair values were determined using a Monte-Carlo simulation and were based on the expected market price of our common stock on the vesting date and the expected number of converted common shares. We realized related tax benefits of \$16.3 million for the three months ended May 31, 2015, from the vesting of market stock units. The unrecognized compensation costs related to nonvested MSUs totaled \$19.2 million as of May 31, 2015. These costs are expected to be recognized on a straight-line basis over a weighted average period of 1.6 years.

## Stock-Settled Performance Stock Unit Activity

|                                     | Number      | Weighted<br>Average<br>Grant<br>Date<br>Fair Value |
|-------------------------------------|-------------|--|
| (Units in thousands)                | of<br>Units |  |
| Outstanding as of February 28, 2015 |             | \$   |
| Stock units granted                 | 66          | \$ 72.58   |
| Stock units vested                  |             | \$   |
| Stock units cancelled               |             | \$   |
| Outstanding as of May 31, 2015      | 66          | \$ 72.58   |

During the three months ended May 31, 2015, we granted 66,446 PSUs. No PSUs were granted in fiscal 2015. The weighted average fair value per PSU at the date of grant for PSUs granted during the three months ended May 31, 2015, was \$72.58. The fair value was the fair market value of a share of common stock on the date of the grant. The unrecognized compensation costs related to nonvested PSUs totaled \$3.9 million as of May 31, 2015. These costs are expected to be recognized on a straight-line basis over a weighted average period of 2.9 years.

## 12. Net Earnings per Share

Basic net earnings per share is computed by dividing net earnings available for basic common shares by the weighted average number of shares of common stock outstanding. Diluted net earnings per share is computed by dividing net earnings available for diluted common shares by the sum of weighted average number of shares of common stock outstanding and dilutive potential common stock. Diluted net earnings per share is calculated using the “if-converted” treasury stock method.

## Basic and Dilutive Net Earnings Per Share Reconciliations

| (In thousands except per share data)                                | Three Months Ended |            |
|---|--------------------|------------|
|   | May 31             |            |
|   | 2015               | 2014       |
| Net earnings  | \$ 181,974         | \$ 169,653 |
| Weighted average common shares outstanding                          | 208,698            | 220,268    |
| Dilutive potential common shares:                                   |                    |            |
| Stock options   | 2,158              | 2,772      |
| Stock-settled stock units and awards                                | 796                | 592        |
| Weighted average common shares and dilutive potential common shares | 211,652            | 223,632    |
| Basic net earnings per share  | \$ 0.87            | \$ 0.77    |
| Diluted net earnings per share                                      | \$ 0.86            | \$ 0.76    |

Certain options to purchase shares of common stock were outstanding and not included in the calculation of diluted net earnings per share because their inclusion would have been antidilutive. On a weighted average basis, for the three months ended May 31, 2015 and 2014, options to purchase 812,356 shares and 2,420,758 shares of common stock, respectively, were not included.

## 13. Accumulated Other Comprehensive Loss

## Changes in Accumulated Other Comprehensive Loss by Component

| (In thousands, net of income taxes)                            | Net<br>Unrecognized<br>Actuarial<br>Losses | Net<br>Unrecognized<br>Hedge Losses | Total<br>Accumulated<br>Other<br>Comprehensive<br>Loss |
|--|--|-------------------------------------|--|
| Balance as of February 28, 2015                                | \$ (59,220)                                | \$ (6,171)                          | \$ (65,391)  |
| Other comprehensive loss before reclassifications              |  | (2,618)                             | (2,618)  |
| Amounts reclassified from accumulated other comprehensive loss | 306  | 1,245                               | 1,551  |
| Other comprehensive income (loss)                              | 306  | (1,373)                             | (1,067)  |
| Balance as of May 31, 2015                                     | \$ (58,914)                                | \$ (7,544)                          | \$ (66,458)  |



## Changes In and Reclassifications Out of Accumulated Other Comprehensive Loss

| (In thousands)   | Three Months<br>Ended May 31 |         |
|--|------------------------------|---------|
|  | 2015                         | 2014    |
| Retirement Benefit Plans (Note 9):   |                              |         |
| Actuarial loss amortization reclassifications recognized in net pension expense: |                              |         |
| Cost of sales  | \$ 195                       | \$ 138  |
| CarMax Auto Finance income   | 11                           | 7       |
| Selling, general and administrative expenses                                     | 283                          | 195     |
| Total amortization reclassifications recognized in net pension expense           | 489                          | 340     |
| Tax expense  | (183)                        | (127)   |
| Amortization reclassifications recognized in net pension expense, net of tax     | 306                          | 213     |
| Net change in retirement benefit plan unrecognized actuarial losses, net of tax  | 306                          | 213     |
| Cash Flow Hedges (Note 5):   |                              |         |
| Effective portion of changes in fair value                                       | (4,316)                      | (1,798) |
| Tax benefit  | 1,698                        | 707     |
| Effective portion of changes in fair value, net of tax                           | (2,618)                      | (1,091) |
| Reclassifications to CarMax Auto Finance income                                  | 2,051                        | 2,263   |
| Tax expense  | (806)                        | (890)   |
| Reclassification of hedge losses, net of tax                                     | 1,245                        | 1,373   |
| Net change in cash flow hedge unrecognized losses, net of tax                    | (1,373)                      | 282     |
| Total other comprehensive (loss) income, net of tax                              | \$ (1,067)                   | \$ 495  |

Changes in the funded status of our retirement plans and the effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in accumulated other comprehensive loss. The cumulative balances are net of deferred taxes of \$39.8 million as of May 31, 2015, and \$39.0 million as of February 28, 2015.

## 14. Contingent Liabilities

Litigation. On April 2, 2008, Mr. John Fowler filed a putative class action lawsuit against CarMax Auto Superstores California, LLC and CarMax Auto Superstores West Coast, Inc. in the Superior Court of California, County of Los Angeles. Subsequently, two other lawsuits, Leena Areso et al. v. CarMax Auto Superstores California, LLC and Justin Weaver v. CarMax Auto Superstores California, LLC, were consolidated as part of the Fowler case. The allegations in the



consolidated case involved: (1) failure to provide meal and rest breaks or compensation in lieu thereof; (2) failure to pay wages of terminated or resigned employees related to meal and rest breaks and overtime; (3) failure to pay overtime; (4) failure to comply with itemized employee wage statement provisions; (5) unfair competition; and (6) California's Labor Code Private Attorney General Act. The putative class consisted of sales consultants, sales managers, and other hourly employees who worked for the company in California from April 2, 2004, to the present. On May 12, 2009, the court dismissed all of the class claims with respect to the sales manager putative class. On June 16, 2009, the court dismissed all claims related to the failure to comply with the itemized employee wage statement provisions. The court also granted CarMax's motion for summary adjudication with regard to CarMax's alleged failure to pay overtime to the sales consultant putative class.

The claims currently remaining in the lawsuit regarding the sales consultant putative class are: (1) failure to provide meal and rest breaks or compensation in lieu thereof; (2) failure to pay wages of terminated or resigned employees related to meal and rest breaks; (3) unfair competition; and (4) California's Labor Code Private Attorney General Act. On November 21, 2011, the court granted CarMax's motion to compel the plaintiffs' remaining claims into arbitration on an individual basis. The plaintiffs appealed the court's ruling and on March 26, 2013, the California Court of Appeal reversed the trial court's order granting CarMax's motion to compel arbitration. On October 8, 2013, CarMax filed a petition for a writ of certiorari seeking review in the United States Supreme Court. On February 24, 2014, the United States Supreme Court granted CarMax's petition for certiorari, vacated the California Court of Appeal decision and remanded the case to the California Court of Appeal for further consideration. The California Court of Appeal determined that the plaintiffs' Labor Code Private Attorney General Act claim is not subject to arbitration, but the remaining claims are subject to arbitration on an individual basis. CarMax appealed this decision on March 9, 2015 by filing a petition for review with the California Supreme Court. On April 22, 2015, the California Supreme Court denied the petition for review. The Fowler lawsuit seeks compensatory and special damages, wages, interest, civil and statutory penalties, restitution, injunctive relief and the recovery of attorneys' fees. We are unable to make a reasonable estimate of the amount or range of loss that could result from an unfavorable outcome in this matter.

We are involved in various other legal proceedings in the normal course of business. Based upon our evaluation of information currently available, we believe that the ultimate resolution of any such proceedings will not have a material adverse effect, either individually or in the aggregate, on our financial condition, results of operations or cash flows.

**Other Matters.** In accordance with the terms of real estate lease agreements, we generally agree to indemnify the lessor from certain liabilities arising as a result of the use of the leased premises, including environmental liabilities and repairs to leased property upon termination of the lease. Additionally, in accordance with the terms of agreements entered into for the sale of properties, we generally agree to indemnify the buyer from certain liabilities and costs arising subsequent to the date of the sale, including environmental liabilities and liabilities resulting from the breach of representations or warranties made in accordance with the agreements. We do not have any known material environmental commitments, contingencies or other indemnification issues arising from these arrangements.

As part of our customer service strategy, we guarantee the used vehicles we retail with at least a 30-day limited warranty. A vehicle in need of repair within this period will be repaired free of charge. As a result, each vehicle sold has an implied liability associated with it. Accordingly, based on historical trends, we record a provision for estimated

future repairs during the guarantee period for each vehicle sold. The liability for this guarantee was \$5.7 million as of May 31, 2015, and \$6.2 million as of February 28, 2015, and is included in accrued expenses and other current liabilities.

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is provided as a supplement to, and should be read in conjunction with, our audited consolidated financial statements, the accompanying notes and the MD&A included in our Annual Report on Form 10-K for the fiscal year ended February 28, 2015 ("fiscal 2015"), as well as our consolidated financial statements and the accompanying notes included in Item 1 of this Form 10-Q. Note references are to the notes to consolidated financial statements included in Item 1. All references to net earnings per share are to diluted net earnings per share. Certain prior year amounts have been reclassified to conform to the current year's presentation. Amounts and percentages may not total due to rounding.

OVERVIEW

CarMax is the nation's largest retailer of used vehicles. We operate in two reportable segments: CarMax Sales Operations and CarMax Auto Finance ("CAF"). Our CarMax Sales Operations segment consists of all aspects of our auto merchandising and service operations, excluding financing provided by CAF. Our CAF segment consists solely of our own finance operation that provides vehicle financing through CarMax stores.

CarMax Sales Operations

Our sales operations segment consists of retail sales of used vehicles and related products and services, such as wholesale vehicle sales; the sale of extended protection plan ("EPP") products, which include extended service plans ("ESP") and guaranteed asset protection ("GAP"); and vehicle repair service. GAP is designed to cover the unpaid balance on an auto loan in the event of a total loss of the vehicle or unrecovered theft. We focus on addressing the major sources of customer dissatisfaction with traditional auto retailers while maximizing operating efficiencies. We offer low, no-haggle prices; a broad selection of CarMax Quality Certified used vehicles; value-added EPP products; and superior customer service.

Our customers finance the majority of the retail vehicles purchased from us, and the availability of on-the-spot financing is a critical component of the sales process. We provide financing to qualified retail customers through CAF and our arrangements with industry-leading third-party finance providers. All of the finance offers, whether by CAF or our third-party providers, are backed by a 3-day payoff option.

As of May 31, 2015, we operated 147 used car stores in 75 U.S. markets, covering 47 mid-sized markets, 21 large markets and 7 small markets. We define mid-sized markets as those with television viewing populations generally

between 600,000 and 3 million people. As of that date, we also conducted wholesale auctions at 63 used car stores and we operated four new car franchises.

#### CarMax Auto Finance

In addition to third-party providers, we provide vehicle financing through CAF, which offers financing solely to our customers in our stores. CAF allows us to manage our reliance on third-party financing providers and to leverage knowledge of our business to provide qualifying customers a competitive financing option. As a result, we believe CAF enables us to capture additional profits, cash flows and sales. After the effect of 3-day payoffs and vehicle returns, CAF financed 42.2% of our retail vehicle unit sales in the first quarter of fiscal 2016. As of May 31, 2015, CAF serviced approximately 647,000 customer accounts in its \$8.86 billion portfolio of managed receivables.

Management regularly analyzes CAF's operating results by assessing the competitiveness of our consumer offer, profitability, the performance of the auto loan receivables including trends in credit losses and delinquencies, and CAF direct expenses.

#### First Quarter Fiscal 2016 Revenues and Profitability

During the first quarter of fiscal 2016, net sales and operating revenues increased 7.1%, net earnings grew 7.3% and net earnings per share increased 13.2% versus the corresponding prior year period. Our ongoing share repurchase program contributed to our earnings per share growth.

Our primary source of revenue and net income is the retail sale of used vehicles. During the first quarter of fiscal 2016, we sold 164,510 used vehicles, representing 98.7% of the total 166,725 vehicles we sold at retail, 82.0% of our net sales and

operating revenues and 66.6% of our gross profit. Used vehicle unit sales grew 9.3%, including a 4.9% increase in comparable store used units and sales from newer stores not yet included in our comparable store base.

Wholesale sales are also a significant contributor to our revenues and net income. During the first quarter of fiscal 2016, we sold 101,630 wholesale vehicles, representing 14.4% of our net sales and operating revenues and 19.3% of our gross profit. Wholesale unit sales grew 4.7%, primarily reflecting the growth in our store base, partially offset by a decline in our vehicle buy rate.

Other sales and revenues, which include commissions earned on the sale of EPP products, service department sales and net third-party finance fees, represented 14.0% of our gross profit in the first quarter of fiscal 2016. Other sales and revenues grew 14.3% versus the prior year's first quarter.

Income from our CAF segment totaled \$109.1 million in the first quarter of fiscal 2016, up 15.3% versus the prior year period. CAF income primarily reflects the interest and fee income generated by the auto loan receivables less the interest expense associated with the debt issued to fund these receivables, a provision for estimated loan losses and direct CAF expenses. CAF income does not include any allocation of indirect costs.

## Liquidity

Our primary ongoing sources of liquidity include funds provided by operations, proceeds from securitization transactions, and borrowings under our revolving credit facility or through other financing sources. During the first quarter of fiscal 2016, liquidity was primarily provided by \$509.1 million of adjusted net cash provided by operating activities (a non-GAAP measure), which includes \$391.5 million of net issuances of non-recourse notes payable. This liquidity was primarily used to fund the increase in CAF auto loan receivables, the 1.8 million common shares repurchased under our share repurchase program and our store growth.

During the first quarter of fiscal 2016, net cash provided by operations totaled \$117.6 million, while net cash provided by operating activities, including the net issuances of non-recourse notes payable, totaled \$509.1 million. When considering cash provided by operating activities, management does not include increases in auto loan receivables that have been securitized with non-recourse notes payable, which are separately reflected as cash provided by financing activities. For a reconciliation of adjusted net cash provided by operations to net cash provided by operating activities, the most directly comparable GAAP financial measure, see "Reconciliation of Adjusted Net Cash from Operating Activities" included in "Financial Condition – Liquidity and Capital Resources."

## Future Outlook

Over the long-term, we believe the primary driver for earnings growth will be vehicle unit sales growth from both new stores and stores included in our comparable store base. We also believe that increased used vehicle unit sales will drive increased sales of wholesale vehicles and ancillary products and, over time, increased CAF income. To expand our vehicle unit sales at new and existing stores, we will need to continue delivering an unrivaled customer experience and hiring and developing the associates necessary to drive our success, while managing the risks posed by an evolving competitive environment. In addition, to support our store growth plans, we will need to continue procuring suitable real estate at favorable terms.

We are still in the midst of the national rollout of our retail concept, and as of May 31, 2015, we had used car stores located in markets that represented approximately 63% of the U.S. population. In the first quarter of fiscal 2016 we opened 3 stores and we plan to open 11 new stores and relocate one store whose lease is expiring during the remainder of fiscal 2016. In each of the following two fiscal years, we plan to open between 13 and 16 stores. See planned store openings included in “Planned Future Activities” for a detailed list of stores planned to be opened in the 12 months following May 31, 2015.

See “Risk Factors,” included in Part I. Item 1A of the Annual Report on Form 10-K for the fiscal year ended February 28, 2015 for additional information about risks and uncertainties facing our Company.

#### CRITICAL ACCOUNTING POLICIES

For information on critical accounting policies, see “Critical Accounting Policies” in MD&A included in Item 7 of the Annual Report on Form 10-K for the fiscal year ended February 28, 2015. These policies relate to financing and securitization transactions, revenue recognition and income taxes.

## RESULTS OF OPERATIONS – CARMAX SALES OPERATIONS

## Net Sales And Operating Revenues

| (In millions)                          | Three Months Ended May 31 |            |         |
|--|---------------------------|------------|---------|
|  | 2015                      | 2014       | Change  |
| Used vehicle sales                     | \$ 3,292.7                | \$ 3,060.3 | 7.6 %   |
| New vehicle sales                      | 60.0                      | 69.8       | (14.0)% |
| Wholesale vehicle sales                | 576.6                     | 545.2      | 5.8 %   |
| Other sales and revenues:              |                           |            |         |
| Extended protection plan revenues      | 71.7                      | 63.7       | 12.5 %  |
| Service department sales               | 30.9                      | 28.3       | 9.0 %   |
| Third-party finance fees, net          | (17.0)                    | (17.2)     | 1.2 %   |
| Total other sales and revenues         | 85.6                      | 74.8       | 14.3 %  |
| Total net sales and operating revenues | \$ 4,014.9                | \$ 3,750.2 | 7.1 %   |

## Unit Sales

|                    | Three Months Ended May 31 |         |          |
|--------------------|---------------------------|---------|----------|
|                    | 2015                      | 2014    | % Change |
| Used vehicles      | 164,510                   | 150,528 | 9.3 %    |
| New vehicles       | 2,215                     | 2,597   | (14.7) % |
| Wholesale vehicles | 101,630                   | 97,098  | 4.7 %    |

## Average Selling Prices

|                    | Three Months Ended May 31 |           |          |
|--------------------|---------------------------|-----------|----------|
|                    | 2015                      | 2014      | % Change |
| Used vehicles      | \$ 19,851                 | \$ 20,173 | (1.6) %  |
| New vehicles       | \$ 26,997                 | \$ 26,761 | 0.9 %    |
| Wholesale vehicles | \$ 5,449                  | \$ 5,450  | (0.0) %  |

Comparable Store Used Vehicle Sales Changes

|                      | Three Months<br>Ended May 31 |       |
|----------------------|------------------------------|-------|
|                      | 2015                         | 2014  |
| Used vehicle units   | 4.9 %                        | 3.4 % |
| Used vehicle dollars | 3.4 %                        | 6.6 % |

Stores are added to the comparable store base beginning in their fourteenth full month of operation. We do not remove renovated stores from our comparable store base. Comparable store calculations include results for a set of stores that were included in our comparable store base in both the current and corresponding prior year periods.



## Vehicle Sales Changes

|                            | Three Months<br>Ended May 31 |       |
|----------------------------|------------------------------|-------|
|                            | 2015                         | 2014  |
| Used vehicle units         | 9.3%                         | 9.8%  |
| Used vehicle revenues      | 7.6%                         | 13.3% |
| Wholesale vehicle units    | 4.7%                         | 9.9%  |
| Wholesale vehicle revenues | 5.8%                         | 11.1% |

## e Sales Changes

## Change in Used Car Store Base

|                                    | Three Months<br>Ended May 31 |      |
|------------------------------------|------------------------------|------|
|                                    | 2015                         | 2014 |
| Used car stores, beginning of year | 144                          | 131  |
| Store openings                     | 3                            | 4    |
| Used car stores, end of period     | 147                          | 135  |

During the first quarter of fiscal 2016, we opened three stores, including two stores in new markets (Minneapolis and Gainesville, Florida). We also opened our third store in the Philadelphia market. The Gainesville store is a small format store. Small format stores are located in smaller markets or areas where the sales opportunity is below that of mid-sized or large markets. While these stores are anticipated to sell fewer vehicles compared with our stores in larger markets, they have a smaller footprint, employ fewer associates and have less overhead compared with other CarMax stores.

Used Vehicle Sales. The 7.6% increase in used vehicle revenues in the first quarter of fiscal 2016 resulted from a 9.3% increase in used unit sales partially offset by a 1.6% decrease in used vehicle average selling price. The increase in used unit sales included a 4.9% increase in comparable store used unit sales and sales from newer stores not yet included in the comparable store base. Comparable store used unit sales benefited from both improved conversion and continued growth in customer traffic. The decrease in average selling price reflected a combination of factors, including lower acquisition costs and changes in the mix of vehicles sold.

Wholesale Vehicle Sales. Our wholesale auction prices usually reflect the trends in the general wholesale market for the types of vehicles we sell, although they can also be affected by changes in vehicle mix or the average age, mileage or condition of the vehicles bought through our appraisal process and sold in our auctions. The 5.8% increase in wholesale vehicle revenues in the first quarter of fiscal 2016 primarily resulted from a 4.7% increase in wholesale unit sales. Wholesale unit sales primarily benefited from the growth in our store base, partially offset by a decline in our vehicle buy rate.

Other Sales and Revenues. Other sales and revenues include commissions on the sale of EPPs, net of a reserve for estimated contract cancellations; service department sales; and net third-party finance fees. We refer to the third-party finance providers who generally pay us a fee as Tier 2 providers and we refer to providers to whom we pay a fee as Tier 3 providers. The fees we pay to the Tier 3 providers are reflected as an offset to finance fee revenues received from the Tier 2 providers. The mix of our retail vehicles financed by CAF, Tier 2 and Tier 3 providers may vary from quarter to quarter depending on several factors including the credit quality of applicants, changes in providers' credit decisioning and external market conditions. Changes in originations by one tier of credit providers may also affect the originations made by providers in other tiers.

Other sales and revenues increased 14.3% in the first quarter of fiscal 2016. EPP revenues rose 12.5% versus the prior year's quarter, primarily due to the growth of our retail unit sales. Net third-party finance fees were relatively flat compared with the first quarter of fiscal 2015, reflecting the net effect of changes in mix among providers and the overall increase in retail units sold. Vehicles financed by the Tier 3 providers and those included in the CAF loan origination test represented 14.5% of retail unit sales in the first quarter of fiscal 2016 versus 16.1% in the corresponding prior year period.

Seasonality. Historically, our business has been seasonal. Our stores typically experience their strongest traffic and sales in the spring and summer quarters. Sales are generally slowest in the fall quarter. We typically experience an increase in traffic and sales in February and March, coinciding with tax refund season.

## Gross Profit

| (In millions)                  | Three Months Ended May 31 |          |        |
|--------------------------------|---------------------------|----------|--------|
|                                | 2015                      | 2014     | Change |
| Used vehicle gross profit      | \$ 361.9                  | \$ 334.1 | 8.3 %  |
| New vehicle gross profit       | 0.8                       | 1.8      | (55.4) |
| Wholesale vehicle gross profit | 104.9                     | 101.6    | 3.3    |
| Other gross profit             | 76.2                      | 64.2     | 18.7   |
| Total                          | \$ 543.8                  | \$ 501.7 | 8.4 %  |

## Gross Profit Per Unit

|                                | Three Months Ended May 31 |      |                |      |
|--------------------------------|---------------------------|------|----------------|------|
|                                | 2015                      |      | 2014           |      |
|                                | \$ per unit(1)            | %(2) | \$ per unit(1) | %(2) |
| Used vehicle gross profit      | \$ 2,200                  | 11.0 | \$ 2,220       | 10.9 |
| New vehicle gross profit       | 371                       | 1.4  | 709            | 2.6  |
| Wholesale vehicle gross profit | 1,032                     | 18.2 | 1,046          | 18.6 |
| Other gross profit             | 457                       | 89.1 | 419            | 85.8 |
| Total gross profit             | \$ 3,262                  | 13.5 | \$ 3,277       | 13.4 |

(1) Calculated as category gross profit divided by its respective units sold, except the other and total categories, which are divided by total retail units sold.

(2) Calculated as a percentage of its respective sales or revenue.

**Used Vehicle Gross Profit.** We target a dollar range of gross profit per used unit sold. The gross profit dollar target for an individual vehicle is based on a variety of factors, including its probability of sale and its mileage relative to its age; however, it is not primarily based on the vehicle's selling price. Our ability to quickly adjust appraisal offers to be consistent with the broader market trade-in trends and the pace of our inventory turns reduce our exposure to the inherent continual fluctuation in used vehicle values and contribute to our ability to manage gross profit per unit.

We systematically mark down individual vehicle prices based on proprietary pricing algorithms in order to appropriately balance sales trends, inventory turns and gross profit achievement. Other factors that may influence gross profit include changes in our vehicle reconditioning costs, changes in the percentage of vehicles sourced directly from consumers through our appraisal process and changes in the wholesale pricing environment. Vehicles purchased directly from consumers typically generate more gross profit per unit compared with vehicles purchased at auction or through other channels.

The 8.3% increase in used vehicle gross profit in the first quarter of fiscal 2016 was primarily driven by the 9.3% increase in total used unit sales. Used vehicle gross profit per unit remained relatively flat compared with the prior year period.

**Wholesale Vehicle Gross Profit.** Our wholesale gross profit per unit reflects the demand for older, higher mileage vehicles, which are the mainstay of our auctions, as well as the continued strong dealer attendance and resulting high dealer-to-car ratios at our auctions. The frequency of our auctions, which are generally held weekly or bi-weekly, minimizes the depreciation risk on these vehicles. Our ability to adjust appraisal offers in response to changes in the wholesale pricing environment is a key factor that influences wholesale gross profit.

The 3.3% increase in wholesale gross profit in the first quarter of fiscal 2016 primarily reflected the 4.7% increase in wholesale unit sales. Wholesale gross profit per unit was similar to prior year's first quarter.

**Other Gross Profit.** Other gross profit includes profits related to EPP revenues, net third-party finance fees and service department operations, including used vehicle reconditioning. We have no cost of sales related to EPP revenues or net third-party finance fees, as these represent commissions paid to us by certain third-party providers. Third-party finance fees are reported net of the fees we pay to Tier 3 providers. Accordingly, changes in the relative mix of the other gross profit components can affect the composition and amount of other gross profit.

Other gross profit rose 18.7% in the first quarter of fiscal 2016, largely due to the improvement in other sales and revenues discussed above.

Impact of Inflation. Historically, inflation has not had a significant impact on results. Profitability is primarily affected by our ability to achieve targeted unit sales and gross profit dollars per vehicle rather than by changes in average retail prices. However, changes in average vehicle selling prices impact CAF income, to the extent the average amount financed also changes.

## Selling, General and Administrative Expenses

### Components of SG&A Expense

| (In millions, except per unit data) | Three Months Ended May 31 |          |        |
|-------------------------------------|---------------------------|----------|--------|
|                                     | 2015                      | 2014     | Change |
| Compensation and benefits (1)       | \$ 201.8                  | \$ 178.9 | 12.8 % |
| Store occupancy costs               | 65.3                      | 58.3     | 12.0   |
| Advertising expense                 | 33.7                      | 30.7     | 9.8    |
| Other overhead costs (2)            | 49.0                      | 45.5     | 7.7    |
| Total SG&A expenses                 | \$ 349.8                  | \$ 313.4 | 11.6 % |
| SG&A per unit                       | \$ 2,098                  | \$ 2,047 | \$ 51  |

(1)Excludes compensation and benefits related to reconditioning and vehicle repair service, which are included in cost of sales.

(2)Includes IT expenses, insurance, non-CAF bad debt, travel, preopening and relocation costs, charitable contributions and other administrative expenses.

SG&A expenses increased 11.6% in the first quarter of fiscal 2016. The increase primarily reflected the 12% growth in our store base since the beginning of last year's first quarter (representing the addition of 16 stores) and a \$7.9 million increase in share-based compensation expense, as well as higher variable selling costs resulting from our 4.9% increase in comparable store used unit sales. SG&A per retail unit for the first quarter of fiscal 2016 was \$2,098, up \$51 year-over-year, of which \$39 related to the increase in share-based compensation expense.

**Interest Expense.** Interest expense includes the interest related to short- and long-term debt and finance and capital lease obligations. It does not include interest on the non-recourse notes payable, which is reflected within CAF income.

Interest expense declined 6.6% to \$7.1 million in the first quarter of fiscal 2016, despite having a higher level of outstanding long-term debt compared with the prior year period. During the first quarter of fiscal 2016, interest expense was reduced by \$2.8 million of capitalized interest while no interest was capitalized during the first quarter of fiscal 2015.

**Income Taxes.** The effective income tax rate was 38.5% in the first quarter of fiscal 2016 versus 38.3% in the first quarter of fiscal 2015.

## RESULTS OF OPERATIONS – CARMAX AUTO FINANCE

CAF income primarily reflects the interest and fee income generated by CAF's portfolio of auto loan receivables less the interest expense associated with the debt issued to fund these receivables, a provision for estimated loan losses and direct CAF expenses. CAF income does not include any allocation of indirect costs. Although CAF benefits from certain indirect overhead expenditures, we have not allocated indirect costs to CAF to avoid making subjective allocation decisions. Examples of indirect costs not allocated to CAF include retail store expenses and corporate expenses such as human resources, administrative services, marketing, information systems, accounting, legal, treasury and executive payroll.

CAF's managed portfolio is composed primarily of loans originated over the past several years. Trends in receivable growth and interest margins primarily reflect the cumulative effect of changes in the business over a multi-year period. Trends in portfolio losses and delinquencies are affected by changes in our origination strategies over time, as well as current economic conditions. Current period originations reflect current trends in both our retail sales and the CAF business, including the volume of loans originated, current interest rates charged to consumers, loan terms and average credit scores. Because we recognize CAF income over the life of the underlying auto loan, loans originated in a given fiscal period generally do not have a significant effect on that period's financial results.

See Note 3 for additional information on CAF income and Note 4 for information on auto loan receivables, including credit quality.

## Components of CAF Income

| (In millions)   | Three Months Ended May 31 |       |            |       |
|---|---------------------------|-------|------------|-------|
|   | 2015                      | % (1) | 2014       | % (1) |
| Interest margin:                                      |                           |       |            |       |
| Interest and fee income                               | \$ 164.9                  | 7.6   | \$ 147.0   | 8.0   |
| Interest expense                                      | (28.1)                    | (1.3) | (23.1)     | (1.2) |
| Total interest margin                                 | 136.8                     | 6.3   | 123.9      | 6.7   |
| Provision for loan losses                             | (13.6)                    | (0.6) | (15.8)     | (0.9) |
| Total interest margin after provision for loan losses | 123.2                     | 5.7   | 108.1      | 5.8   |
| Total direct expenses                                 | (14.1)                    | (0.7) | (13.5)     | (0.7) |
| CarMax Auto Finance income                            | \$ 109.1                  | 5.0   | \$ 94.6    | 5.1   |
| Total average managed receivables                     | \$ 8,664.6                |       | \$ 7,390.1 |       |

(1) Annualized percentage of total average managed receivables.

The 15.3% increase in CAF income in the first quarter of fiscal 2016 was attributable to a combination of factors, including an increase in average managed receivables and continued favorable loss experience, partially offset by a lower total interest margin percentage. Average managed receivables grew 17.2% to \$8.66 billion in the current year's first quarter. In recent quarters, we experienced better-than-anticipated loan charge-offs, which had a favorable effect on both the provision for loan losses and the ending allowance for loan losses.

The total interest margin, which reflects the spread between interest and fees charged to consumers and our funding costs, declined as a percentage of average managed receivables to 6.3% in the first quarter of fiscal 2016 from 6.7% in the corresponding prior year period. This was the result of gradual compression of the spread between rates charged to consumers and our funding costs in recent years. Changes in the interest margin on new originations affect CAF income over time. Rising interest rates, which affect CAF's funding costs, or further competitive pressures on consumer rates could result in further compression in the interest margin on new originations.



## CAF Origination Information

|  | Three Months Ended May |   |            |   |
|--|------------------------|---|------------|---|
|  | 31                     |   |            |   |
|  | 2015 (1)               |   | 2014 (1)   |   |
| Net loans originated (in millions)       | \$ 1,364.7             |   | \$ 1,236.3 |   |
| Vehicle units financed                   | 70,293                 |   | 63,191     |   |
| Penetration rate (2)                     | 42.2                   | % | 41.3       | % |
| Weighted average contract rate           | 7.4                    | % | 7.2        | % |
| Weighted average credit score (3)        | 698                    |   | 699        |   |
| Weighted average loan-to-value (LTV) (4) | 94.4                   | % | 93.4       | % |
| Weighted average term (in months)        | 65.8                   |   | 65.5       |   |

(1) All information relates to loans originated net of 3-day payoffs and vehicle returns.

(2) Vehicle units financed as a percentage of total retail units sold.

(3) The credit scores represent FICO scores, and reflect only receivables with obligors that have a FICO score at the time of application. The FICO score with respect to any receivable with co-obligors is calculated as the average of each obligor's FICO score at the time of application. FICO scores are not a significant factor in our primary scoring model which relies on information from credit bureaus and other application information as discussed in Note 4. FICO® is a federally registered servicemark of Fair Isaac Corporation.

(4) LTV represents the ratio of the amount financed to the total collateral value, which is measured as the vehicle selling price plus applicable taxes, title and fees.

Net loans originated in the first quarter of fiscal 2016 grew 10.4% to \$1.36 billion largely due to the growth in our retail unit sales, as well as an increase in CAF's penetration rate to 42.2% from 41.3% in the prior year's first quarter.

Loan Origination Test. In January 2014, CAF launched a test originating loans for customers who typically would be financed by our Tier 3 providers. As of May 31, 2015, a total of \$87.2 million of net loans had been originated in this test. Because the loans in this test have higher loss and delinquency rates than the remainder of the CAF portfolio, they also have higher contract rates. The test is being funded separately from the remainder of CAF's portfolio and is not included in our current securitization program.

## Allowance for Loan Losses

| (In millions)                   | As of May 31 |       |         |       |
|---------------------------------|--------------|-------|---------|-------|
|                                 | 2015         | % (1) | 2014    | % (1) |
| Balance as of beginning of year | \$ 81.7      | 0.97  | \$ 69.9 | 0.97  |

|                             |         |      |         |      |
|-----------------------------|---------|------|---------|------|
| Charge-offs                 | (34.3)  |      | (32.0)  |      |
| Recoveries                  | 22.7    |      | 21.7    |      |
| Provision for loan losses   | 13.6    |      | 15.8    |      |
| Balance as of end of period | \$ 83.7 | 0.94 | \$ 75.4 | 1.00 |

(1)Percent of total ending managed receivables.

The allowance for loan losses represents an estimate of the amount of net losses inherent in our portfolio of managed receivables as of the applicable reporting date and anticipated to occur during the following 12 months. The 11.0% year-over-year increase in the dollar amount of the end-of-period allowance largely reflected the growth in managed receivables. The decrease in the allowance for loan losses as a percent of managed receivables resulted from the better-than-anticipated net credit loss experience.

## Loan Performance Information

| (In millions)   | Three Months Ended May |   |            |   |
|---|------------------------|---|------------|---|
|   | 31                     |   | 31         |   |
|   | 2015                   |   | 2014       |   |
| Net credit losses on managed receivables  | \$ 11.6                |   | \$ 10.3    |   |
| Total average managed receivables   | \$ 8,664.6             |   | \$ 7,390.1 |   |
| Annualized net credit losses as a percentage of total average managed receivables | 0.54                   | % | 0.56       | % |
| Total ending managed receivables  | \$ 8,862.6             |   | \$ 7,573.8 |   |
| Past due accounts as a percentage of ending managed receivables                   | 2.65                   | % | 2.51       | % |
| Average recovery rate   | 54.8                   | % | 57.8       | % |

The average recovery rate represents the average percentage of the outstanding principal balance we receive when a vehicle is repossessed and liquidated, generally at our wholesale auctions. The annual recovery rate has ranged from a low of 42% to a high of 60%, and it is primarily affected by changes in the wholesale market pricing environment.

## PLANNED FUTURE ACTIVITIES

In fiscal 2016, we plan to open 14 new stores and relocate one store whose lease is expiring. In each of the following two years, we plan to open between 13 and 16 stores. In fiscal 2016, we also plan to remodel approximately 15 older stores. We currently estimate capital expenditures will total approximately \$360 million in fiscal 2016.

We currently plan to open the following stores within 12 months from May 31, 2015:

## Planned Store Openings – Next 12 Months

| Location | Television Market | Market Status | Planned Opening Date |
|----------|-------------------|---------------|----------------------|
|----------|-------------------|---------------|----------------------|

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|                            |                      |          |                |
|----------------------------|----------------------|----------|----------------|
| Cranston, Rhode Island (1) | Providence           | Existing | Q2 Fiscal 2016 |
| Parker, Colorado (1)       | Denver               | Existing | Q2 Fiscal 2016 |
| Loveland, Colorado (1)     | Denver               | Existing | Q2 Fiscal 2016 |
| Tallahassee, Florida       | Tallahassee          | New      | Q2 Fiscal 2016 |
| Richmond, Texas            | Houston              | Existing | Q3 Fiscal 2016 |
| Gaithersburg, Maryland (2) | Washington/Baltimore | Existing | Q3 Fiscal 2016 |
| Maplewood, Minnesota       | Minneapolis/St Paul  | Existing | Q3 Fiscal 2016 |
| Norwood, Massachusetts     | Boston               | New      | Q4 Fiscal 2016 |
| Danvers, Massachusetts     | Boston               | Existing | Q4 Fiscal 2016 |
| Bloomington, Illinois      | Peoria/Bloomington   | New      | Q4 Fiscal 2016 |
| Buford, Georgia            | Atlanta              | Existing | Q4 Fiscal 2016 |
| O'Fallon, Illinois         | St. Louis            | Existing | Q4 Fiscal 2016 |
| Pleasanton, California     | San Francisco        | New      | Q1 Fiscal 2017 |
| Santa Rosa, California     | San Francisco        | Existing | Q1 Fiscal 2017 |
| Springfield, Illinois      | Springfield          | New      | Q1 Fiscal 2017 |

(1) Store opened in June 2015.

(2) Represents a store relocation being made in connection with the expiration of the lease on our Rockville, Maryland store.

Normal construction, permitting or other scheduling delays could shift the opening dates of any of these stores into a later period.

## FINANCIAL CONDITION

### Liquidity and Capital Resources.

Our primary ongoing cash requirements are to fund our existing operations, store expansion and improvement (including capital expenditures and inventory purchases) and CAF. Since fiscal 2013, we have also elected to use cash to repurchase stock as part of our share repurchase program. Our primary ongoing sources of liquidity include funds provided by operations, proceeds from securitization transactions or other funding arrangements, and borrowings under our revolving credit facility or through other financing sources.

**Operating Activities.** During the first quarter of fiscal 2016, we generated \$117.6 million of net cash from operating activities, while we used \$209.1 million in operating activities in the prior year's first quarter. The net cash provided by or used in operating activities included increases in auto loan receivables of \$391.0 million in the current year period and \$415.7 million in the prior year period. The majority of the increases in auto loan receivables are accompanied by increases in non-recourse notes payable, which are separately reflected as cash provided by financing activities. When considering cash provided by operating activities, management uses an adjusted measure of net cash from operating activities that offsets the changes in auto loan receivables with the corresponding changes in non-recourse notes payable. This is achieved by adding back the cash provided from the net issuances of non-recourse notes payable, which represents the increase in auto loan receivables that were securitized through the issuance of non-recourse notes payable during the period. The resulting financial measure, adjusted net cash from operating activities, is a non-GAAP financial measure. We believe adjusted net cash from operating activities is a meaningful metric for investors because it provides better visibility into the cash generated from operations. Including the increases in non-recourse notes payable, net cash provided by operating activities would have been as follows:

### Reconciliation of Adjusted Net Cash from Operating Activities

| (In millions)  | Three Months<br>Ended May 31 |            |
|--|------------------------------|------------|
|  | 2015                         | 2014       |
| Net cash provided by (used in) operating activities  | \$ 117.6                     | \$ (209.1) |
| Add: Net issuances of non-recourse notes payable (1) | 391.5                        | 378.5      |
| Adjusted net cash provided by operating activities   | \$ 509.1                     | \$ 169.4   |

(1)

Calculated using the gross issuances less payments on non-recourse notes payable as disclosed on the consolidated statements of cash flows.

As of May 31, 2015, total inventory was \$1.84 billion, representing a decrease of \$242.8 million or 11.6%, compared with the balance as of the start of the fiscal year. The decrease reflected a return to more normal inventory levels after having built inventories in the latter portion of fiscal 2015 to better position ourselves for seasonal sales opportunities. Compared with May 31, 2014, inventories increased 9.6%, primarily reflecting the growth of our store base.

**Investing Activities.** Net cash used in investing activities totaled \$97.1 million in the first quarter of fiscal 2016 compared with \$94.1 million in the first quarter of fiscal 2015. Capital expenditures were \$59.4 million in the current year period versus \$53.7 million in the prior year period. Capital expenditures primarily include real estate acquisitions for planned future store openings, store construction costs and store remodeling expenses. We maintain a multi-year pipeline of sites to support our store growth, so portions of capital spending in one year may relate to stores that we open in subsequent fiscal years.

As of May 31, 2015, we owned 90 and leased 57 of our 147 used car locations.

**Financing Activities.** During the first three months of the fiscal year, net cash provided by financing activities totaled \$303.6 million in fiscal 2016 compared with \$207.5 million in fiscal 2015. Included in these amounts were net increases in total non-recourse notes payable of \$391.5 million and \$378.5 million, respectively, which were used to provide the financing for the majority of the increases of \$391.0 million and \$415.7 million, respectively, in auto loan receivables (see Operating Activities). Net cash provided by financing activities was reduced by stock repurchases of \$117.6 million in the first quarter of fiscal 2016 compared with \$171.9 million in the first quarter of fiscal 2015.

## Total Debt and Cash and Cash Equivalents

|  | As of May<br>31<br>2015 | As of<br>February 28<br>2015 |
|--|-------------------------|------------------------------|
| (In thousands)                             |                         |                              |
| Borrowings under revolving credit facility | \$ 781                  | \$ 10,785                    |
| Other long-term debt                       | 300,000                 | 300,000                      |
| Finance and capital lease obligations      | 323,103                 | 327,838                      |
| Non-recourse notes payable                 | 8,862,123               | 8,470,629                    |
| Total debt                                 | \$ 9,486,007            | \$ 9,109,252                 |
| Cash and cash equivalents                  | \$ 351,698              | \$ 27,606                    |

We have a \$1.0 billion unsecured revolving credit facility, which expires in August 2016. Borrowings under this credit facility are available for working capital and general corporate purposes, and the unused portion is fully available to us. See Note 10 for additional information on the revolving credit facility.

In November 2014, we entered into a \$300 million floating rate term loan due November 2017. See Note 10 for additional information on the term loan.

The credit facility and term loan agreements contain representations and warranties, conditions and covenants. If these requirements were not met, all amounts outstanding or otherwise owed could become due and payable immediately and other limitations could be placed on our ability to use any available borrowing capacity.

CAF auto loan receivables are primarily funded through securitization transactions. Our securitizations are structured to legally isolate the auto loan receivables, and we would not expect to be able to access the assets of our securitization vehicles, even in insolvency, receivership or conservatorship proceedings. Similarly, the investors in the non-recourse notes payable have no recourse to our assets beyond the securitized receivables, the amounts on deposit in reserve accounts and the restricted cash from collections on auto loan receivables. We do, however, continue to have the rights associated with the interest we retain in these securitization vehicles. Loans originated in the CAF loan origination test are being funded using existing working capital and are not included in our current securitization program.

The timing of principal payments on the non-recourse notes payable is based on principal collections, net of losses, on the securitized auto loan receivables. The current portion of non-recourse notes payable represents principal payments that are due to be distributed in the following period.

As of May 31, 2015, \$7.77 billion of non-recourse notes payable was outstanding related to term securitizations. These notes payable accrue interest predominantly at fixed rates and have scheduled maturities through November 2021, but may mature earlier, depending on the repayment rate of the underlying auto loan receivables. During the first quarter of fiscal 2016, we completed one term securitization, funding a total of \$1.17 billion of auto loan receivables.

As of May 31, 2015, \$1.09 billion of non-recourse notes payable was outstanding related to our warehouse facilities. We have periodically increased our warehouse facility limit over time, as our store base, sales and CAF loan originations have grown. As of May 31, 2015, the combined warehouse facility limit was \$2.3 billion, and unused warehouse capacity totaled \$1.21 billion. Of the combined warehouse facility limit, \$800 million will expire in July 2015 and \$1.5 billion will expire in February 2016. The return requirements of the warehouse facility investors could fluctuate significantly depending on market conditions. At renewal, the cost, structure and capacity of the facilities could change. These changes could have a significant effect on our funding costs. See Notes 2 and 10 for additional information on the warehouse facilities.

The securitization agreements related to the warehouse facilities include various representations and warranties, covenants and performance triggers. If these requirements are not met, we could be unable to continue to securitize receivables through the warehouse facilities. In addition, warehouse facility investors could charge us a higher rate of interest and could have us replaced as servicer. Further, we could be required to deposit collections on the securitized receivables with the warehouse facility agents on a daily basis and deliver executed lockbox agreements to the warehouse facility agents.

We expect that adjusted net cash provided by operations and other funding arrangements, sale-leaseback transactions and borrowings under existing, new or expanded credit facilities will be sufficient to fund CAF, capital expenditures, repurchases of stock and working capital for the foreseeable future. We anticipate that we will be able to enter into new, or renew or



expand existing, funding arrangements to meet our future funding needs. However, based on conditions in the credit markets, the cost for these arrangements could be materially higher than historical levels and the timing and capacity of these transactions could be dictated by market availability rather than our requirements.

Beginning in fiscal 2013, our board of directors authorized the repurchase of our common stock. Purchases may be made in open market or privately negotiated transactions at management's discretion, and the timing and amount of repurchases are determined based on share price, market conditions, legal requirements and other factors. Shares repurchased are deemed authorized but unissued shares of common stock. As of May 31, 2015, the board had authorized a total of \$3.8 billion of repurchases. At that date, \$2.25 billion was available for repurchase under the authorizations, of which \$249.3 million expires on December 31, 2015, and \$2.0 billion expires on December 31, 2016. See Note 11 for more information on share repurchase activity.

**Fair Value Measurements.** We report money market securities, mutual fund investments and derivative instruments at fair value. See Note 6 for more information on fair value measurements.

## FORWARD-LOOKING STATEMENTS

We caution readers that the statements contained in this report about our future business plans, operations, opportunities, or prospects, including without limitation any statements or factors regarding expected sales, margins, expenditures, CAF income, or earnings, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by use of words such as “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “outlook,” “plan,” “predict,” “should,” “similar expressions, whether in the negative or affirmative. Such forward-looking statements are based upon management’s current knowledge and assumptions about future events and involve risks and uncertainties that could cause actual results to differ materially from anticipated results. We disclaim any intent or obligation to update these statements. Among the factors that could cause actual results and outcomes to differ materially from those contained in the forward-looking statements are the following:

- § Changes in the competitive landscape and/or our failure to successfully adjust to such changes.
- § Events that damage our reputation or harm the perception of the quality of our brand.
- § Changes in general or regional U.S. economic conditions.
- § Changes in the availability or cost of capital and working capital financing, including changes related to the asset-backed securitization market.
- § Changes in the attractiveness or availability of consumer credit provided by our third-party financing providers.
- § Changes in the availability of extended protection plan products from third-party providers.
- § Our inability to recruit, develop and retain associates and maintain positive associate relations.
- § The loss of key associates from our store, regional or corporate management teams or a significant increase in labor costs.
- § Security breaches or other events that result in the misappropriation, loss or other unauthorized disclosure of confidential customer or associate information.
- § Significant changes in prices of new and used vehicles.
- § A reduction in the availability of or access to sources of inventory or a failure to expeditiously liquidate inventory.
- § Factors related to the regulatory and legislative environment in which we operate.
- § Factors related to geographic growth, including the inability to acquire or lease suitable real estate at favorable terms or to effectively manage our growth.
- § The failure of key information systems.
- § The effect of various litigation matters.
- § Adverse conditions affecting one or more automotive manufacturers, and manufacturer recalls.
- § The inaccuracy of estimates and assumptions used in the preparation of our financial statements, or the effect of new accounting requirements or changes to U.S. generally accepted accounting principles.
- § Factors related to the seasonal fluctuations in our business.
- § The occurrence of severe weather events.
- § Factors related to the geographic concentration of our stores.

For more details on factors that could affect expectations, see Part II, Item 1A, “Risk Factors” on Page 40 of this report, our Annual Report on Form 10-K for the fiscal year ended February 28, 2015, and our quarterly or current reports as filed with or furnished to the U.S. Securities and Exchange Commission (“SEC”). Our filings are publicly available on our investor information home page at [investors.carmax.com](http://investors.carmax.com). Requests for information may also be made to our Investor Relations Department by email to [investor\\_relations@carmax.com](mailto:investor_relations@carmax.com) or by calling 1-804-747-0422, ext. 4391. We undertake no obligation to update or revise any forward-looking statements after the date they are made, whether as a result of new information, future events or otherwise.



Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to our market risk since February 28, 2015. For information on our exposure to market risk, refer to Part II, Item 7A, “Quantitative and Qualitative Disclosures about Market Risk,” contained in our Annual Report on Form 10-K for the year ended February 28, 2015.

Item 4. Controls and Procedures

Disclosure. We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (“Exchange Act”)) that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Our disclosure controls and procedures are also designed to ensure that this information is accumulated and communicated to management, including the chief executive officer (“CEO”) and the chief financial officer (“CFO”), as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, with the participation of the CEO and CFO, we evaluated the effectiveness of our disclosure controls and procedures. Based upon that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period.

Internal Control over Financial Reporting. There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended May 31, 2015, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

For a discussion of legal proceedings, see Note 14 to the consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

### Item 1A. Risk Factors

In connection with information set forth in this Form 10-Q, the factors discussed under “Risk Factors” in our Form 10-K for fiscal year ended February 28, 2015, should be considered. These risks could materially and adversely affect our business, financial condition, and results of operations. There have been no material changes to the factors discussed in our Form 10 K.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In fiscal 2013, our board of directors authorized the repurchase of up to \$800 million of our common stock which was exhausted in fiscal 2015. On April 4, 2014, we announced that the board had authorized the repurchase of up to an additional \$1 billion of our common stock, expiring on December 31, 2015. On October 22, 2014, we announced that the board had further authorized the repurchase of up to an additional \$2 billion of our common stock, expiring on December 31, 2016. Purchases may be made in open market or privately negotiated transactions at management’s discretion and the timing and amount of repurchases are determined based on share price, market conditions, legal requirements and other factors. Shares repurchased are deemed authorized but unissued shares of common stock.

The following table provides information relating to the company’s repurchase of common stock for the first quarter of fiscal 2016. The table does not include transactions related to employee equity awards or the exercises of employee stock options.

Approximate  
Dollar Value

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| Period                 | Total Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid<br>per Share | Total Number<br>of Shares Purchased<br>as Part of Publicly<br>Announced Program | of Shares that<br>May Yet Be<br>Purchased Under<br>the Program |
|------------------------|--|---------------------------------------|---|--|
| March<br>1-31,<br>2015 | 956,471                                | \$ 64.62                              | 956,471   | \$ 2,307,451,509   |
| April<br>1-30,<br>2015 | 269,600                                | \$ 69.35                              | 269,600   | \$ 2,288,754,848   |
| May<br>1-31,<br>2015   | 550,858                                | \$ 71.56                              | 550,858   | \$ 2,249,335,540   |
| Total                  | 1,776,929                              |                                       | 1,776,929   |  |

Item 6.Exhibits

3.1 CarMax, Inc. Bylaws, as amended and restated April 13, 2015, filed as Exhibit 3.1 to CarMax's Current Report on Form 8-K, filed April 13, 2015 (File No. 1-31420), are incorporated by this reference.

31.1 Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a), filed herewith.

31.2 Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a), filed herewith.

32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, filed herewith.

32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, filed herewith.

101.INSXBRL Instance Document

101.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEFBRL Taxonomy Extension Definition Linkbase Document

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PREXBRL Taxonomy Extension Presentation Linkbase Document

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.

CARMAX, INC.

By: /s/ Thomas J. Folliard  
Thomas J. Folliard  
President and  
Chief Executive Officer

By: /s/ Thomas W. Reedy  
Thomas W. Reedy  
Executive Vice President and  
Chief Financial Officer

July 8, 2015

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EXHIBIT INDEX

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