

**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 August 31, 2019**

**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**

(State or other jurisdiction of incorporation)

**54-1821055**

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

**12800 Tuckahoe Creek Parkway**

**23238**

**Richmond, Virginia**

(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)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock	KMX	New York Stock Exchange

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 every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

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

**Class**

**Outstanding as of September 30, 2019**

Common Stock, par value \$0.50

164,430,050

**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)

<i>(In thousands except per share data)</i>	Three Months Ended August 31				Six Months Ended August 31			
	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>
<b>SALES AND OPERATING REVENUES:</b>								
Used vehicle sales	\$ 4,346,295	83.6	\$ 3,975,368	83.4	\$ 8,886,952	84.1	\$ 7,996,415	83.7
Wholesale vehicle sales	678,286	13.0	627,990	13.2	1,340,735	12.7	1,245,641	13.0
Other sales and revenues	176,570	3.4	162,677	3.4	339,782	3.2	316,571	3.3
<b>NET SALES AND OPERATING REVENUES</b>	<b>5,201,151</b>	<b>100.0</b>	4,766,035	100.0	<b>10,567,469</b>	<b>100.0</b>	9,558,627	100.0
<b>COST OF SALES:</b>								
Used vehicle cost of sales	3,889,917	74.8	3,546,383	74.4	7,933,741	75.1	7,127,992	74.6
Wholesale vehicle cost of sales	560,906	10.8	516,913	10.8	1,097,396	10.4	1,019,858	10.7
Other cost of sales	56,875	1.1	52,103	1.1	100,496	1.0	98,801	1.0
<b>TOTAL COST OF SALES</b>	<b>4,507,698</b>	<b>86.7</b>	4,115,399	86.3	<b>9,131,633</b>	<b>86.4</b>	8,246,651	86.3
<b>GROSS PROFIT</b>	<b>693,453</b>	<b>13.3</b>	650,636	13.7	<b>1,435,836</b>	<b>13.6</b>	1,311,976	13.7
<b>CARMAX AUTO FINANCE INCOME</b>	<b>114,131</b>	<b>2.2</b>	109,667	2.3	<b>230,090</b>	<b>2.2</b>	225,260	2.4
Selling, general and administrative expenses	480,831	9.2	453,554	9.5	970,491	9.2	891,788	9.3
Interest expense	21,073	0.4	17,950	0.4	38,857	0.4	36,002	0.4
Other expense (income)	143	—	(686)	—	(216)	—	277	—
Earnings before income taxes	305,537	5.9	289,485	6.1	656,794	6.2	609,169	6.4
Income tax provision	71,938	1.4	68,595	1.4	156,451	1.5	149,623	1.6
<b>NET EARNINGS</b>	<b>\$ 233,599</b>	<b>4.5</b>	\$ 220,890	4.6	<b>\$ 500,343</b>	<b>4.7</b>	\$ 459,546	4.8
<b>WEIGHTED AVERAGE COMMON SHARES:</b>								
Basic	165,354		176,284		165,839		177,211	
Diluted	167,272		178,200		167,458		178,811	
<b>NET EARNINGS PER SHARE:</b>								
Basic	\$ 1.41		\$ 1.25		\$ 3.02		\$ 2.59	
Diluted	\$ 1.40		\$ 1.24		\$ 2.99		\$ 2.57	

<sup>(1)</sup> 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)**

<i>(In thousands)</i>	Three Months Ended August 31		Six Months Ended August 31	
	2019	2018	2019	2018
<b>NET EARNINGS</b>	\$ 233,599	\$ 220,890	\$ 500,343	\$ 459,546
Other comprehensive (loss) income, net of taxes				
Net change in retirement benefit plan unrecognized actuarial losses	356	370	711	739
Net change in cash flow hedge unrecognized losses	(10,780)	240	(24,331)	(862)
Other comprehensive (loss) income, net of taxes	(10,424)	610	(23,620)	(123)
<b>TOTAL COMPREHENSIVE INCOME</b>	\$ 223,175	\$ 221,500	\$ 476,723	\$ 459,423

*See accompanying notes to consolidated financial statements.*

**CARMAX, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**(Unaudited)**

<i>(In thousands except share data)</i>	As of August 31 2019	As of February 28 2019
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 40,737	\$ 46,938
Restricted cash from collections on auto loan receivables	483,374	440,669
Accounts receivable, net	141,091	139,850
Inventory	2,604,750	2,519,455
Other current assets	114,987	67,101
<b>TOTAL CURRENT ASSETS</b>	<b>3,384,939</b>	<b>3,214,013</b>
Auto loan receivables, net	13,065,959	12,428,487
Property and equipment, net of accumulated depreciation of \$1,199,375 and \$1,297,393 as of August 31, 2019 and February 28, 2019, respectively	2,981,260	2,828,058
Deferred income taxes	66,048	61,346
Operating lease assets	456,449	—
Other assets	185,599	185,963
<b>TOTAL ASSETS</b>	<b>\$ 20,140,254</b>	<b>\$ 18,717,867</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 628,507	\$ 593,171
Accrued expenses and other current liabilities	301,503	318,204
Accrued income taxes	1,389	3,784
Current portion of operating lease liabilities	30,066	—
Short-term debt	915	1,129
Current portion of long-term debt	10,762	10,177
Current portion of non-recourse notes payable	423,562	385,044
<b>TOTAL CURRENT LIABILITIES</b>	<b>1,396,704</b>	<b>1,311,509</b>
Long-term debt, excluding current portion	1,689,079	1,649,244
Non-recourse notes payable, excluding current portion	12,695,050	12,127,290
Operating lease liabilities, excluding current portion	448,640	—
Other liabilities	299,224	272,796
<b>TOTAL LIABILITIES</b>	<b>16,528,697</b>	<b>15,360,839</b>
Commitments and contingent liabilities		
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock, \$0.50 par value; 350,000,000 shares authorized; 164,885,648 and 167,478,924 shares issued and outstanding as of August 31, 2019 and February 28, 2019, respectively	82,442	83,739
Capital in excess of par value	1,313,290	1,237,153
Accumulated other comprehensive loss	(91,630)	(68,010)
Retained earnings	2,307,455	2,104,146
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>3,611,557</b>	<b>3,357,028</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 20,140,254</b>	<b>\$ 18,717,867</b>

*See accompanying notes to consolidated financial statements.*

**CARMAX, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**

<i>(In thousands)</i>	<b>Six Months Ended August 31</b>	
	<b>2019</b>	<b>2018</b>
<b>OPERATING ACTIVITIES:</b>		
Net earnings	\$ 500,343	\$ 459,546
Adjustments to reconcile net earnings to net cash (used in) provided by operating activities:		
Depreciation and amortization	103,468	90,311
Share-based compensation expense	68,887	54,234
Provision for loan losses	83,693	70,863
Provision for cancellation reserves	45,471	38,699
Deferred income tax provision	3,812	2,539
Other	3,718	1,358
Net (increase) decrease in:		
Accounts receivable, net	(1,241)	28,438
Inventory	(85,295)	33,339
Other current assets	(48,452)	22,161
Auto loan receivables, net	(721,165)	(675,614)
Other assets	15,421	(7,167)
Net (decrease) increase in:		
Accounts payable, accrued expenses and other current liabilities and accrued income taxes	(26,632)	57,639
Other liabilities	(67,484)	(65,461)
<b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES</b>	<b>(125,456)</b>	<b>110,885</b>
<b>INVESTING ACTIVITIES:</b>		
Capital expenditures	(171,347)	(171,111)
Proceeds from disposal of property and equipment	3	565
Purchases of investments	(8,244)	(5,306)
Sales of investments	720	904
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(178,868)</b>	<b>(174,948)</b>
<b>FINANCING ACTIVITIES:</b>		
(Decrease) increase in short-term debt, net	(214)	3,169
Proceeds from issuances of long-term debt	3,293,500	1,300,600
Payments on long-term debt	(3,284,866)	(1,460,584)
Cash paid for debt issuance costs	(10,862)	(8,189)
Payments on finance lease obligations	(1,694)	(335)
Issuances of non-recourse notes payable	5,748,000	5,486,502
Payments on non-recourse notes payable	(5,141,901)	(4,878,974)
Repurchase and retirement of common stock	(341,929)	(381,347)
Equity issuances	86,521	47,502
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>346,555</b>	<b>108,344</b>
Increase in cash, cash equivalents, and restricted cash	42,231	44,281
Cash, cash equivalents, and restricted cash at beginning of year	595,377	554,898
<b>CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT END OF PERIOD</b>	<b>\$ 637,608</b>	<b>\$ 599,179</b>

**RECONCILIATION OF CASH, CASH EQUIVALENTS AND RESTRICTED CASH TO THE CONSOLIDATED BALANCE SHEETS:**

Cash and cash equivalents	\$	40,737	\$	37,147
Restricted cash from collections on auto loan receivables		483,374		447,642
Restricted cash included in other assets		113,497		114,390
<b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH AT END OF PERIOD</b>	<b>\$</b>	<b>637,608</b>	<b>\$</b>	<b>599,179</b>

*See accompanying notes to consolidated financial statements.*

**CARMAX, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Shareholders' Equity**  
**(Unaudited)**

**Three and Six Months Ended August 31, 2019**

<i>(In thousands)</i>	Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	<b>Balance as of February 28, 2019</b>	<b>167,479</b>	<b>\$ 83,739</b>	<b>\$ 1,237,153</b>	<b>\$ 2,104,146</b>	<b>\$ (68,010)</b>
Net earnings	—	—	—	266,744	—	266,744
Other comprehensive loss	—	—	—	—	(13,196)	(13,196)
Share-based compensation expense	—	—	18,912	—	—	18,912
Repurchases of common stock	(2,953)	(1,476)	(21,991)	(181,368)	—	(204,835)
Exercise of common stock options	727	363	32,888	—	—	33,251
Stock incentive plans, net shares issued	142	71	(5,220)	—	—	(5,149)
<b>Balance as of May 31, 2019</b>	<b>165,395</b>	<b>\$ 82,697</b>	<b>\$ 1,261,742</b>	<b>\$ 2,189,522</b>	<b>\$ (81,206)</b>	<b>\$ 3,452,755</b>
Net earnings	—	—	—	233,599	—	233,599
Other comprehensive loss	—	—	—	—	(10,424)	(10,424)
Share-based compensation expense	—	—	10,757	—	—	10,757
Repurchases of common stock	(1,526)	(763)	(11,933)	(115,666)	—	(128,362)
Exercise of common stock options	1,008	504	52,766	—	—	53,270
Stock incentive plans, net shares issued	9	4	(42)	—	—	(38)
<b>Balance as of August 31, 2019</b>	<b>164,886</b>	<b>\$ 82,442</b>	<b>\$ 1,313,290</b>	<b>\$ 2,307,455</b>	<b>\$ (91,630)</b>	<b>\$ 3,611,557</b>

**Three and Six Months Ended August 31, 2018**

<i>(In thousands)</i>	Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	<b>Balance as of February 28, 2018</b>	<b>179,748</b>	<b>\$ 89,874</b>	<b>\$ 1,234,047</b>	<b>\$ 2,047,240</b>	<b>\$ (54,312)</b>
Net earnings	—	—	—	238,656	—	238,656
Other comprehensive loss	—	—	—	—	(733)	(733)
Share-based compensation expense	—	—	16,645	—	—	16,645
Repurchases of common stock	(3,308)	(1,654)	(22,824)	(182,926)	—	(207,404)
Exercise of common stock options	212	106	8,946	—	—	9,052
Stock incentive plans, net shares issued	68	34	(2,202)	—	—	(2,168)
Adoption of ASU 2014-09	—	—	—	12,864	—	12,864
<b>Balance as of May 31, 2018</b>	<b>176,720</b>	<b>\$ 88,360</b>	<b>\$ 1,234,612</b>	<b>\$ 2,115,834</b>	<b>\$ (55,045)</b>	<b>\$ 3,383,761</b>
Net earnings	—	—	—	220,890	—	220,890
Other comprehensive income	—	—	—	—	610	610
Share-based compensation expense	—	—	9,695	—	—	9,695
Repurchases of common stock	(2,291)	(1,146)	(16,334)	(153,746)	—	(171,226)
Exercise of common stock options	860	430	38,019	—	—	38,449

Stock incentive plans, net shares issued	1	1	(62)	—	—	(61)
<b>Balance as of August 31, 2018</b>	<b>175,290</b>	<b>\$ 87,645</b>	<b>\$ 1,265,930</b>	<b>\$ 2,182,978</b>	<b>\$ (54,435)</b>	<b>\$ 3,482,118</b>

*See accompanying notes to consolidated financial statements.*

**CARMAX, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**1. Background**

**Business.** 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 financing to customers buying retail vehicles from CarMax.

We deliver an unrivaled customer experience by offering a broad selection of quality used vehicles and related products and services at competitive, no-haggle prices using a customer-friendly sales process in an attractive, modern sales facility, as well as through carmax.com and our mobile apps. We provide customers with a range of related products and services, including the appraisal and purchase of vehicles directly from consumers; the financing of retail vehicle purchases through CAF and third-party finance providers; the sale of extended protection plan (“EPP”) products, which include extended service plans (“ESPs”) 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.

**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.

The accounting policies followed in the presentation of our interim financial results are consistent with those included in the company's Annual Report on Form 10-K for the fiscal year ended February 28, 2019 (the “2019 Annual Report”), with the exception of those related to recent accounting pronouncements adopted in the current fiscal year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in our 2019 Annual Report.

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.

In connection with our adoption of Accounting Standards Update (“ASU”) 2016-02, *Leases* (“ASC 842”) during the current fiscal year, certain prior period amounts have been reclassified to conform to the current period's presentation. In the consolidated balance sheets, financing obligations have been reclassified to current portion of long-term debt and long-term debt, excluding current portion. Also, capital lease obligations have been reclassified to accrued expenses and other current liabilities and other liabilities. In the consolidated statements of cash flows, payments on financing obligations have been reclassified to payments on long-term debt. See Notes 9 and 13 for additional information on financing obligations and leases, respectively.

***Recent Accounting Pronouncements.***

***Adopted in the Current Period.***

In August 2018, the FASB issued an accounting pronouncement (FASB ASU 2018-13) related to disclosure requirements for fair value measurements. The pronouncement eliminates, modifies and adds disclosure requirements for fair value measurements. The pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. We early adopted this pronouncement during the second quarter of fiscal 2020, and it did not have a material effect on our consolidated financial statements.

***Effective in Future Periods.***

In June 2016, the FASB issued an accounting pronouncement (FASB ASU 2016-13) related to the measurement of credit losses on financial instruments. This pronouncement, along with subsequent ASUs issued to clarify certain provisions of ASU 2016-13, changes the impairment model for most financial assets and will require the use of an “expected loss” model for instruments measured at amortized cost. Under this model, entities will be required to estimate the lifetime expected credit loss on such



instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. This pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2019. We plan to adopt this pronouncement for our fiscal year beginning March 1, 2020. We are currently evaluating the effect on our consolidated financial statements, as well as the impacts on our business processes, systems and internal controls, and expect that the standard will have a material impact on our calculation of the allowance for loan losses.

## 2. Revenue

We recognize revenue when control of the good or service has been transferred to the customer, generally either at the time of sale or upon delivery to a customer. Our contracts have a fixed contract price and revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods or providing services. 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. We generally expense sales commissions when incurred because the amortization period would have been less than one year. These costs are recorded within selling, general and administrative expenses. We do not have any significant payment terms as payment is received at or shortly after the point of sale.

### Disaggregation of Revenue

<i>(In millions)</i>	Three Months Ended August 31		Six Months Ended August 31	
	2019	2018	2019	2018
Used vehicle sales	\$ 4,346.3	\$ 3,975.4	\$ 8,887.0	\$ 7,996.4
Wholesale vehicle sales	678.3	628.0	1,340.7	1,245.6
Other sales and revenues:				
Extended protection plan revenues	113.3	98.5	224.6	198.6
Third-party finance fees, net	(10.3)	(9.7)	(25.8)	(24.2)
Service revenues	33.4	36.1	67.3	72.7
Other	40.2	37.8	73.7	69.5
Total other sales and revenues	176.6	162.7	339.8	316.6
Total net sales and operating revenues	\$ 5,201.2	\$ 4,766.0	\$ 10,567.5	\$ 9,558.6

**Used Vehicle Sales.** Revenue from the sale of used vehicles is recognized upon transfer of control of the vehicle to the customer. As part of our customer service strategy, we guarantee the retail vehicles we sell with a 7-day, money-back guarantee. We record a reserve for estimated returns based on historical experience and trends. The reserve for estimated returns is presented gross on the consolidated balance sheets, with a return asset recorded in other current assets and a refund liability recorded in accrued expenses and other current liabilities. We also guarantee the used vehicles we sell with a 90-day/4,000 mile limited warranty. These warranties are deemed assurance-type warranties and accounted for as warranty obligations. See Note 15 for additional information on this warranty and its related obligation.

**Wholesale Vehicle Sales.** Wholesale vehicles are sold at our auctions, and revenue from the sale of these vehicles is recognized upon transfer of control of the vehicle to the customer. Dealers also pay a fee to us based on the sale price of the vehicles they purchase. This fee is recognized as revenue at the time of sale. While we provide condition disclosures on each wholesale vehicle sold, the vehicles are subject to a limited right of return. We record a reserve for estimated returns based on historical experience and trends. The reserve for estimated returns is presented gross on the consolidated balance sheets, with a return asset recorded in other current assets and a refund liability recorded in accrued expenses and other current liabilities.

**EPP Revenues.** We also sell ESP and GAP products on behalf of unrelated third parties, who are primarily responsible for fulfilling the contract, to customers who purchase a retail vehicle. The ESPs we currently offer on all used vehicles provide coverage up to 60 months (subject to mileage limitations), while GAP covers the customer for the term of their finance contract. We recognize revenue, on a net basis, at the time of sale. We also record a reserve for estimated contract cancellations. 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 revenue 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 accrued expenses and other current liabilities with the remaining amount recognized in other liabilities. See Note 7 for additional information on cancellation reserves.

We are contractually entitled to receive profit-sharing revenues based on the performance of the ESPs administered by third parties. These revenues are a form of variable consideration included in EPP revenues to the extent that it is probable that it will not result in a significant revenue reversal. An estimate of the amount to which we expect to be entitled, subject to various constraints, is recognized upon satisfying the performance obligation of selling the ESP. These constraints include factors that are outside of the company's influence or control and the length of time until settlement. We apply the expected value method, utilizing historical claims and cancellation data from CarMax customers, as well as external data and other qualitative assumptions. This estimate is reassessed each reporting period with changes reflected in other sales and revenues on our consolidated statements of earnings and other assets on our consolidated balance sheets. Profit-sharing payments by the ESP provider begin when the underlying ESPs reach a specified level of claims history. As of August 31, 2019 and February 28, 2019, we recognized a contract asset of \$32.2 million and \$25.7 million, respectively, related to cumulative profit-sharing payments to which we expect to be entitled. During the current quarter, this amount was reclassified from other assets to other current assets on our consolidated balance sheets, as we expect to begin receiving ESP profit-sharing payments in the first calendar quarter of 2020. While the initial payment could be up to \$50 million, the revenue recognized to-date represents the amount for which we have determined it is probable it will not result in a significant revenue reversal. The first payment reflects the accumulation of profit-sharing for four years under our current contracts with the providers, while any subsequent profit-sharing payments we receive will only reflect one year of incremental earnings.

**Third-Party Finance Fees.** Customers applying for financing who are not approved or are conditionally approved by CAF are generally evaluated by other 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.

**Service Revenues.** Service revenue consists of labor and parts income related to vehicle repair service, including repairs of vehicles covered under an ESP we sell or warranty program. Service revenue is recognized at the time the work is completed.

**Other Revenues.** Other revenues consist primarily of new vehicle sales at our two new car franchise locations and sales of accessories. Revenue in this category is recognized upon transfer of control to the customer.

### **3. CarMax Auto Finance**

CAF provides financing to qualified retail customers purchasing vehicles from CarMax. 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 or other funding arrangements to fund loans originated by CAF. 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. 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 August 31				Six Months Ended August 31			
	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>
Interest margin:								
Interest and fee income	\$ 275.7	8.5	\$ 242.2	8.0	\$ 541.9	8.4	\$ 474.5	8.0
Interest expense	(90.6)	(2.8)	(69.1)	(2.3)	(178.0)	(2.8)	(132.9)	(2.2)
Total interest margin	185.1	5.7	173.1	5.7	363.9	5.7	341.6	5.7
Provision for loan losses	(45.5)	(1.4)	(40.0)	(1.3)	(83.7)	(1.3)	(70.9)	(1.2)
Total interest margin after provision for loan losses	139.6	4.3	133.1	4.4	280.2	4.4	270.7	4.5
Total other expense	—	—	(0.3)	—	—	—	(0.3)	—
Direct expenses:								
Payroll and fringe benefit expense	(10.4)	(0.3)	(9.6)	(0.3)	(20.5)	(0.3)	(19.2)	(0.3)
Other direct expenses	(15.1)	(0.5)	(13.5)	(0.4)	(29.6)	(0.5)	(25.9)	(0.4)
Total direct expenses	(25.5)	(0.8)	(23.1)	(0.8)	(50.1)	(0.8)	(45.1)	(0.8)
CarMax Auto Finance income	\$ 114.1	3.5	\$ 109.7	3.6	\$ 230.1	3.6	\$ 225.3	3.8
Total average managed receivables	\$ 13,012.1		\$ 12,067.5		\$ 12,859.7		\$ 11,921.4	

<sup>(1)</sup> 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 an asset-backed term funding transaction, such as a term securitization or alternative funding arrangement. We recognize transfers of auto loan receivables into the warehouse facilities and asset-backed term funding transactions (together, “non-recourse funding 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 majority of the auto loan receivables serve as collateral for the related non-recourse notes payable of \$13.14 billion as of August 31, 2019 and \$12.54 billion as of February 28, 2019. See Note 9 for additional information on non-recourse notes payable.

#### Auto Loan Receivables, Net

(In millions)	As of August 31 2019	As of February 28 2019
Asset-backed term funding	\$ 10,452.9	\$ 10,273.4
Warehouse facilities	2,265.0	1,877.0
Overcollateralization <sup>(1)</sup>	295.2	273.3
Other managed receivables <sup>(2)</sup>	118.4	86.5
Total ending managed receivables	13,131.5	12,510.2
Accrued interest and fees	59.3	49.6
Other	25.6	6.9
Less allowance for loan losses	(150.4)	(138.2)
Auto loan receivables, net	\$ 13,066.0	\$ 12,428.5

<sup>(1)</sup> Represents receivables restricted as excess collateral for the non-recourse funding vehicles.

<sup>(2)</sup> Other managed receivables includes receivables not funded through the non-recourse funding vehicles.

***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

<i>(In millions)</i>	As of August 31		As of February 28	
	2019 <sup>(1)</sup>	% <sup>(2)</sup>	2019 <sup>(1)</sup>	% <sup>(2)</sup>
A	\$ 6,533.6	49.8	\$ 6,225.6	49.8
B	4,753.5	36.2	4,488.2	35.9
C and other	1,844.4	14.0	1,796.4	14.3
Total ending managed receivables	\$ 13,131.5	100.0	\$ 12,510.2	100.0

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

<sup>(2)</sup> Percent of total ending managed receivables.

### Allowance for Loan Losses

<i>(In millions)</i>	Three Months Ended August 31				Six Months Ended August 31			
	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>
Balance as of beginning of period	\$ 147.0	1.14	\$ 134.3	1.13	\$ 138.2	1.10	\$ 128.6	1.11
Charge-offs	(76.3)		(64.9)		(142.2)		(123.8)	
Recoveries	34.2		28.7		70.7		62.4	
Provision for loan losses	45.5		40.0		83.7		70.9	
Balance as of end of period	\$ 150.4	1.15	\$ 138.1	1.13	\$ 150.4	1.15	\$ 138.1	1.13

<sup>(1)</sup> 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 expected to become evident during the following 12 months. The allowance is primarily based on the composition of the portfolio of managed receivables, historical loss trends and forecasted forward loss curves. We also take into account recent trends in delinquencies and defaults, recovery rates and the economic environment. The provision for loan losses is the periodic expense of maintaining an adequate allowance.

### Past Due Receivables

<i>(In millions)</i>	As of August 31		As of February 28	
	2019	% <sup>(1)</sup>	2019	% <sup>(1)</sup>
Total ending managed receivables	\$ 13,131.5	100.0	\$ 12,510.2	100.0
Delinquent loans:				
31-60 days past due	\$ 292.0	2.2	\$ 276.5	2.2
61-90 days past due	140.8	1.1	141.4	1.1
Greater than 90 days past due	33.7	0.3	33.9	0.3
Total past due	\$ 466.5	3.6	\$ 451.8	3.6

<sup>(1)</sup> Percent of total ending managed receivables.

## 5. Derivative Instruments and Hedging Activities

We use derivatives to manage certain risks arising from both our business operations and economic conditions, particularly with regard to issuances of 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, and designate these derivative instruments as cash flow hedges for accounting purposes. 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.

For the derivatives associated with our non-recourse funding vehicles, changes in fair value are initially recorded in accumulated other comprehensive loss ("AOCL"). For the majority of these derivatives, the 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 debt. During the next 12 months, we estimate that an additional \$10.8 million will be reclassified in AOCL as a decrease to CAF income.

As of August 31, 2019 and February 28, 2019, we had interest rate swaps outstanding with a combined notional amount of \$2.53 billion and \$2.23 billion, respectively, that were designated as cash flow hedges of interest rate risk.

See Note 6 for discussion of fair values of financial instruments and Note 12 for the effect on comprehensive income.

## 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 and other assets. They consist of highly liquid investments with original maturities of three months or less and are classified as Level 1.

**Mutual Fund Investments.** Mutual fund investments consist of publicly traded mutual funds that primarily include diversified equity investments in large-, mid- and small-cap domestic and international companies or investment grade debt securities. The investments, which are included in other assets, are held in a rabbi trust established to fund informally our executive deferred compensation plan and are classified as Level 1.

**Derivative Instruments.** The fair values of our derivative instruments are included in either other current assets, other assets, accounts payable or other liabilities. 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

	<b>As of August 31, 2019</b>		
<i>(In thousands)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>
<b>Assets:</b>			
Money market securities	\$ 272,991	\$ —	\$ 272,991
Mutual fund investments	21,663	—	21,663
Derivative instruments	—	1	1
<b>Total assets at fair value</b>	<b>\$ 294,654</b>	<b>\$ 1</b>	<b>\$ 294,655</b>
Percent of total assets at fair value	100.0%	—%	100.0%
Percent of total assets	1.5%	—%	1.5%
<b>Liabilities:</b>			
Derivative instruments	\$ —	\$ (15,747)	\$ (15,747)
<b>Total liabilities at fair value</b>	<b>\$ —</b>	<b>\$ (15,747)</b>	<b>\$ (15,747)</b>
Percent of total liabilities	—%	(0.1)%	(0.1)%
	<b>As of February 28, 2019</b>		
<i>(In thousands)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>
<b>Assets:</b>			
Money market securities	\$ 372,448	\$ —	\$ 372,448
Mutual fund investments	19,263	—	19,263
Derivative instruments	—	1,844	1,844
<b>Total assets at fair value</b>	<b>\$ 391,711</b>	<b>\$ 1,844</b>	<b>\$ 393,555</b>
Percent of total assets at fair value	99.5%	0.5%	100.0%
Percent of total assets	2.1%	—%	2.1%
<b>Liabilities:</b>			
Derivative instruments	\$ —	\$ (6,120)	\$ (6,120)
<b>Total liabilities at fair value</b>	<b>\$ —</b>	<b>\$ (6,120)</b>	<b>\$ (6,120)</b>
Percent of total liabilities	—%	—%	—%

## Fair Value of Financial Instruments

The carrying value of our cash and cash equivalents, accounts receivable, other restricted cash deposits and accounts payable approximates fair value due to the short-term nature and/or variable rates associated with these financial instruments. Auto loan receivables are presented net of an allowance for estimated loan losses. We believe that the carrying value of our revolving credit facility and term loan approximates fair value due to the variable rates associated with these obligations. The fair value of our senior unsecured notes, which are not carried at fair value on our consolidated balance sheets, was determined using Level 2 inputs based on quoted market prices. The carrying value and fair value of the senior unsecured notes as of August 31, 2019 and February 28, 2019, respectively, are as follows:

<i>(In thousands)</i>	<b>As of August 31, 2019</b>		<b>As of February 28, 2019</b>	
Carrying value	\$	<b>500,000</b>	\$	500,000
Fair value	\$	<b>532,508</b>	\$	488,590

## 7. Cancellation Reserves

We recognize revenue for EPP products, on a net basis, at the time of sale. We also record 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

<i>(In millions)</i>	<b>Three Months Ended August 31</b>		<b>Six Months Ended August 31</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
Balance as of beginning of period	\$ <b>109.5</b>	\$ 108.7	\$ <b>102.8</b>	\$ 105.2
Cancellations	<b>(17.9)</b>	(16.7)	<b>(36.7)</b>	(33.3)
Provision for future cancellations	<b>20.0</b>	18.6	<b>45.5</b>	38.7
Balance as of end of period	\$ <b>111.6</b>	\$ 110.6	\$ <b>111.6</b>	\$ 110.6

The current portion of estimated cancellation reserves is recognized as a component of accrued expenses and other current liabilities with the remaining amount recognized in other liabilities. As of August 31, 2019 and February 28, 2019, the current portion of cancellation reserves was \$59.9 million and \$55.6 million, respectively.

## 8. Income Taxes

We had \$30.1 million of gross unrecognized tax benefits as of August 31, 2019, and \$30.3 million as of February 28, 2019. There were no significant changes to the gross unrecognized tax benefits as reported for the year ended February 28, 2019.

## 9. Debt

<i>(In thousands)</i>		As of August 31	As of February 28
Debt Description <sup>(1)</sup>	Maturity Date	2019	2019
Revolving credit facility <sup>(2)</sup>	June 2024	\$ 379,515	\$ 366,529
Term loan <sup>(2)</sup>	June 2024	300,000	300,000
3.86% Senior notes	April 2023	100,000	100,000
4.17% Senior notes	April 2026	200,000	200,000
4.27% Senior notes	April 2028	200,000	200,000
Financing obligations	Various dates through February 2059	522,897	495,626
Non-recourse notes payable	Various dates through January 2026	13,141,504	12,535,405
Total debt		14,843,916	14,197,560
Less: current portion		(435,239)	(396,350)
Less: unamortized debt issuance costs		(24,548)	(24,676)
Long-term debt, net		\$ 14,384,129	\$ 13,776,534

<sup>(1)</sup> Interest is payable monthly, with the exception of our senior notes, which are payable semi-annually.

<sup>(2)</sup> Borrowings accrue interest at variable rates based on the Eurodollar rate (LIBOR), the federal funds rate, or the prime rate, depending on the type of borrowing.

**Revolving Credit Facility.** Borrowings under our \$1.45 billion unsecured revolving credit facility (the “credit facility”) are available for working capital and general corporate purposes. We pay a commitment fee on 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 as no repayments are expected to be made within the next 12 months. As of August 31, 2019, the unused capacity of \$1.07 billion was fully available to us.

**Term Loan.** Borrowings under our \$300 million term loan are available for working capital and general corporate purposes. The term loan was classified as long-term debt, as no repayments are scheduled to be made within the next 12 months.

**Senior Notes.** Borrowings under our unsecured senior notes totaling \$500 million are available for working capital and general corporate purposes. These notes were classified as long-term debt as no repayments are scheduled to be made within the next 12 months.

**Financing Obligations.** Financing obligations relate to stores subject to sale-leaseback transactions that did not qualify for sale accounting. The financing obligations were structured at varying interest rates and generally have initial lease terms ranging from 15 to 20 years with payments made monthly. We have not entered into any new sale-leaseback transactions since fiscal 2009. In the event the agreements are modified or extended beyond their original term, the related obligation is adjusted based on the present value of the revised future payments, with a corresponding change to the assets subject to these transactions. Upon modification, the amortization of the obligation is reset, resulting in more of the payments being applied to interest expense in the initial years following the modification.

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

Notes payable related to our asset-backed term funding transactions accrue interest predominantly at fixed rates and have scheduled maturities through January 2026, but may mature earlier, depending upon the repayment rate of the underlying auto loan receivables.

Information on our funding vehicles for non-recourse notes payable as of August 31, 2019, are as follows:

<i>(in billions)</i>	<b>Capacity</b>	
Warehouse facilities		
September 2019 expiration <sup>(1)</sup>	\$	0.15
February 2020 expiration		1.95
August 2020 expiration		1.40
Combined warehouse facility limit	\$	3.50
Unused capacity	\$	1.24
Non-recourse notes payable outstanding:		
Warehouse facilities	\$	2.26
Asset-backed term funding transactions		10.88
Non-recourse notes payable	\$	13.14

<sup>(1)</sup> In September 2019, the expiration date was extended to September 2020.

We enter into warehouse facility agreements for one-year terms and generally renew the agreements annually. 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 Note 4 for additional information on the related auto loan receivables.

**Capitalized Interest.** We capitalize interest in connection with the construction of certain facilities. For the six months ended August 31, 2019 and 2018, we capitalized interest of \$3.3 million and \$3.1 million, respectively.

**Financial Covenants.** The credit facility, term loan and senior note agreements contain representations and warranties, conditions and covenants. We must also meet financial covenants in conjunction with certain financing obligations. The agreements governing our non-recourse funding vehicles contain representations and warranties, financial covenants and performance triggers. As of August 31, 2019, we were in compliance with all financial covenants and our non-recourse funding vehicles were in compliance with the related performance triggers.

## 10. Stock and Stock-Based Incentive Plans

### (A) Share Repurchase Program

As of August 31, 2019, a total of \$2.0 billion of board authorizations for repurchases of our common stock was outstanding, with no expiration date, of which \$1.78 billion remained available for repurchase.

#### Common Stock Repurchases

	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2019	2018	2019	2018
Number of shares repurchased <i>(in thousands)</i>	1,525.5	2,291.7	4,478.6	5,599.3
Average cost per share	\$ 84.13	\$ 74.70	\$ 74.38	\$ 67.61
Available for repurchase, as of end of period <i>(in millions)</i>	\$ 1,780.8	\$ 638.3	\$ 1,780.8	\$ 638.3

## (B) Share-Based Compensation

### Composition of Share-Based Compensation Expense

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2019	2018	2019	2018
Cost of sales	\$ 1,340	\$ 1,603	\$ 4,165	\$ 2,894
CarMax Auto Finance income	1,044	1,237	2,849	2,434
Selling, general and administrative expenses	21,903	22,775	62,796	49,752
Share-based compensation expense, before income taxes	\$ 24,287	\$ 25,615	\$ 69,810	\$ 55,080

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

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2019	2018	2019	2018
Nonqualified stock options	\$ 6,321	\$ 6,493	\$ 18,163	\$ 17,608
Cash-settled restricted stock units (RSUs)	13,105	15,540	39,218	27,894
Stock-settled market stock units (MSUs)	3,052	2,643	7,461	7,279
Other share-based incentives:				
Stock-settled performance stock units (PSUs)	(576)	320	1,633	726
Restricted stock (RSAs)	—	(54)	—	433
Stock-settled deferred stock units (DSUs)	1,960	294	2,412	294
Employee stock purchase plan	425	379	923	846
Total other share-based incentives	\$ 1,809	\$ 939	\$ 4,968	\$ 2,299
Share-based compensation expense, before income taxes	\$ 24,287	\$ 25,615	\$ 69,810	\$ 55,080

## (C) Stock Incentive Plan Information

### Share/Unit Activity

<i>(Shares/units in thousands)</i>	Six Months Ended August 31, 2019			
	Equity Classified			Liability Classified
	Options	MSUs	Other	RSUs
Outstanding as of February 28, 2019	7,869	509	164	1,609
Granted	1,588	129	83	562
Exercised or vested and converted	(1,735)	(149)	(81)	(496)
Cancelled	(16)	(5)	—	(69)
Outstanding as of August 31, 2019	7,706	484	166	1,606

Weighted average grant date fair value per share/unit:

Granted	\$ 22.09	\$ 98.50	\$ 80.55	\$ 78.61
Ending outstanding	\$ 18.11	\$ 83.89	\$ 70.97	\$ 66.86

**As of August 31, 2019**

Unrecognized compensation (*in millions*)

<b>\$</b>	<b>53.0</b>	<b>\$</b>	<b>18.4</b>	<b>\$</b>	<b>5.3</b>
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## 11. 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

<i>(In thousands except per share data)</i>	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2019	2018	2019	2018
Net earnings	\$ 233,599	\$ 220,890	\$ 500,343	\$ 459,546
Weighted average common shares outstanding	165,354	176,284	165,839	177,211
Dilutive potential common shares:				
Stock options	1,579	1,462	1,289	1,194
Stock-settled stock units and awards	339	454	330	406
Weighted average common shares and dilutive potential common shares	167,272	178,200	167,458	178,811
Basic net earnings per share	\$ 1.41	\$ 1.25	\$ 3.02	\$ 2.59
Diluted net earnings per share	\$ 1.40	\$ 1.24	\$ 2.99	\$ 2.57

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 August 31, 2019 and 2018, options to purchase 1,288,413 shares and 2,210,917 shares of common stock, respectively, were not included. For the six months ended August 31, 2019 and 2018, options to purchase 1,096,811 shares and 3,805,873 shares of common stock, respectively, were not included.

## 12. Accumulated Other Comprehensive Loss

### Changes in Accumulated Other Comprehensive Loss By Component

<i>(In thousands, net of income taxes)</i>	Net	Net	Total
	Unrecognized	Unrecognized	Accumulated
	Actuarial	Hedge Gains	Other
	Losses	(Losses)	Comprehensive
	Losses	(Losses)	Loss
Balance as of February 28, 2019	\$ (70,478)	\$ 2,468	\$ (68,010)
Other comprehensive loss before reclassifications	—	(24,554)	(24,554)
Amounts reclassified from accumulated other comprehensive loss	711	223	934
Other comprehensive income (loss)	711	(24,331)	(23,620)
Balance as of August 31, 2019	\$ (69,767)	\$ (21,863)	\$ (91,630)

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

<i>(In thousands)</i>	Three Months Ended August 31		Six Months Ended August 31	
	2019	2018	2019	2018
<b>Retirement Benefit Plans:</b>				
Actuarial loss amortization reclassifications recognized in net pension expense:				
Cost of sales	\$ 201	\$ 204	\$ 398	\$ 405
CarMax Auto Finance income	12	12	24	25
Selling, general and administrative expenses	256	271	515	544
Total amortization reclassifications recognized in net pension expense	469	487	937	974
Tax expense	(113)	(117)	(226)	(235)
Amortization reclassifications recognized in net pension expense, net of tax	356	370	711	739
Net change in retirement benefit plan unrecognized actuarial losses, net of tax	356	370	711	739
<b>Cash Flow Hedges (Note 5):</b>				
Changes in fair value	(15,431)	2,187	(33,373)	1,800
Tax benefit (expense)	4,077	(577)	8,819	(475)
Changes in fair value, net of tax	(11,354)	1,610	(24,554)	1,325
Reclassifications to CarMax Auto Finance income	780	(1,861)	303	(2,970)
Tax (expense) benefit	(206)	491	(80)	783
Reclassification of hedge losses (gains), net of tax	574	(1,370)	223	(2,187)
Net change in cash flow hedge unrecognized losses, net of tax	(10,780)	240	(24,331)	(862)
Total other comprehensive (loss) income, net of tax	\$ (10,424)	\$ 610	\$ (23,620)	\$ (123)

Changes in the funded status of our retirement plans and 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 \$29.9 million as of August 31, 2019 and \$21.4 million as of February 28, 2019.

### 13. Leases

Our leases primarily consist of operating and finance leases related to retail stores, office space, land and equipment. We also have stores subject to sale-leaseback transactions that did not qualify for sale accounting and are accounted for as financing obligations. For more information on these financing obligations see Note 9.

The initial term for real property leases is typically 5 to 20 years. For equipment leases, the initial term generally ranges from 3 to 8 years. Most leases include one or more options to renew, with renewal terms that can extend the lease term from 1 to 20 years or more. We include options to renew (or terminate) in our lease term, and as part of our right-of-use ("ROU") assets and lease liabilities, when it is reasonably certain that we will exercise that option.

ROU assets and the related lease liabilities are initially measured at the present value of future lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our collateralized incremental borrowing rate based on the information available at the commencement date in determining the present value of future payments. We include variable lease payments in the initial measurement of ROU assets and lease liabilities only to the extent they depend on an index or rate. Changes in such indices or rates are accounted for in the period the change occurs, and do not result in the remeasurement of the ROU asset or liability. We are also responsible for payment of certain real estate taxes, insurance and other expenses on our leases. These amounts are generally considered to be variable and are not included in the measurement of the ROU asset and lease liability. We generally account for non-lease

components, such as maintenance, separately from lease components. For certain equipment leases, we apply a portfolio approach to account for the lease assets and liabilities.

Our lease agreements do not contain any material residual value guarantees or material restricted covenants. Leases with a term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term.

The components of lease expense were as follows:

<i>(In thousands)</i>	<b>Three Months Ended August 31, 2019</b>	<b>Six Months Ended August 31, 2019</b>
Operating lease cost <sup>(1)</sup>	\$ 14,257	\$ 28,812
Finance lease cost:		
Depreciation of lease assets	1,453	2,551
Interest on lease liabilities	1,969	3,446
Total finance lease cost	3,422	5,997
Total lease cost	\$ 17,679	\$ 34,809

<sup>(1)</sup> Includes short-term leases and variable lease costs, which are immaterial.

Supplemental balance sheet information related to leases was as follows:

<i>(In thousands)</i>	<b>Classification</b>	<b>As of August 31, 2019</b>
<b>Assets:</b>		
Operating lease assets	Operating lease assets	\$ 456,449
Finance lease assets	Property and equipment, net <sup>(1)</sup>	70,499
Total lease assets		\$ 526,948
<b>Liabilities:</b>		
Current:		
Operating leases	Current portion of operating lease liabilities	\$ 30,066
Finance leases	Accrued expenses and other current liabilities	3,672
Long-term:		
Operating leases	Operating lease liabilities, excluding current portion	448,640
Finance leases	Other liabilities	71,999
Total lease liabilities		\$ 554,377

<sup>(1)</sup> Finance lease assets are recorded net of accumulated depreciation of \$5.9 million as of August 31, 2019.

Lease term and discount rate information related to leases was as follows:

<b>Lease Term and Discount Rate</b>	<b>As of August 31, 2019</b>
<b>Weighted Average Remaining Lease Term (in years)</b>	
Operating leases	20.27
Finance leases	14.35
<b>Weighted Average Discount Rate</b>	
Operating leases	5.41%
Finance leases	10.50%

Supplemental cash flow information related to leases was as follows:

<i>(In thousands)</i>	<b>Six Months Ended August 31, 2019</b>	
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$	<b>28,601</b>
Operating cash flows from finance leases		<b>1,581</b>
Financing cash flows from finance leases		<b>1,694</b>
Lease assets obtained in exchange for lease obligations:		
Operating leases		<b>19,137</b>
Finance leases		<b>43,653</b>

Maturities of lease liabilities were as follows:

<i>(In thousands)</i>	<b>As of August 31, 2019</b>	
	<b>Operating Leases <sup>(1)</sup></b>	<b>Finance Leases <sup>(1)</sup></b>
Fiscal 2020, remaining	\$ 27,247	\$ 4,726
Fiscal 2021	52,990	12,110
Fiscal 2022	49,802	12,332
Fiscal 2023	47,339	12,529
Fiscal 2024	46,204	15,164
Thereafter	612,822	95,111
Total lease payments	836,404	151,972
Less: interest	(357,698)	(76,301)
Present value of lease liabilities	\$ 478,706	\$ 75,671

<sup>(1)</sup> Lease payments exclude \$36.9 million of legally binding minimum lease payments for leases signed but not yet commenced.

As previously disclosed in our 2019 Annual Report and under the previous lease accounting standard, future minimum lease obligations were as follows:

<i>(In thousands)</i>	<b>As of February 28, 2019</b>	
	<b>Capital Leases <sup>(1)</sup></b>	<b>Operating Lease Commitments <sup>(1)</sup></b>
Fiscal 2020	\$ 5,139	\$ 55,295
Fiscal 2021	6,055	52,142
Fiscal 2022	6,185	48,886
Fiscal 2023	6,288	46,235
Fiscal 2024	5,186	45,067
Fiscal 2025 and thereafter	11,445	595,047
Total minimum lease payments	40,298	\$ 842,672
Less amounts representing interest	(8,518)	
Present value of net minimum lease payments	\$ 31,780	

<sup>(1)</sup> Excludes taxes, insurance and other costs payable directly by us. These costs vary from year to year and are incurred in the ordinary course of business.

#### 14. Supplemental Cash Flow Information

Supplemental disclosures of cash flow information:

<i>(In thousands)</i>	Six Months Ended August 31	
	2019	2018
Non-cash investing and financing activities:		
Increase (decrease) in accrued capital expenditures	\$ 2,226	\$ (5,509)
Increase in financing obligations	\$ 31,893	\$ 19,605

See Note 13 for supplemental cash flow information related to leases.

#### 15. Contingent Liabilities

**Litigation.** CarMax entities are defendants in four proceedings asserting wage and hour claims with respect to CarMax sales consultants and non-exempt employees in California. The asserted claims include failure to pay minimum wage, provide meal periods and rest breaks, pay statutory/contractual wages, reimburse for work-related expenses and provide accurate itemized wage statements; unfair competition; and Private Attorney General Act claims. On September 4, 2015, Craig Weiss et al., v. CarMax Auto Superstores California, LLC, and CarMax Auto Superstores West Coast, Inc., a putative class action, was filed in the Superior Court of California, County of Placer. The Weiss lawsuit seeks civil penalties, fines, cost of suit, and the recovery of attorneys' fees. On June 29, 2016, Ryan Gomez et al. v. CarMax Auto Superstores California, LLC, and CarMax Auto Superstores West Coast, Inc., a putative class action, was filed in the Superior Court of the State of California, Los Angeles. The Gomez lawsuit seeks declaratory relief, unspecified damages, restitution, statutory penalties, interest, cost and attorneys' fees. On October 31, 2017, Joshua Sabanovich v. CarMax Superstores California, LLC et. al., a putative class action, was filed in the Superior Court of California, County of Stanislaus. The Sabanovich lawsuit seeks unspecified damages, restitution, statutory penalties, interest, cost and attorneys' fees. On November 21, 2018, Derek Mcelhannon et al v. CarMax Auto Superstores California, LLC and CarMax Auto Superstores West Coast, Inc., a putative class action, was filed in Superior Court of California, County of Alameda. On February 1, 2019, the Mcelhannon lawsuit was removed to the U.S. District Court, Northern District of California, San Francisco Division. The lawsuit was remanded back to the Superior Court of California, County of Alameda on June 4, 2019. The Mcelhannon lawsuit seeks unspecified damages, restitution, statutory and/or civil penalties, interest, cost and attorneys' fees. Based upon our evaluation of information currently available, we believe that the ultimate resolution of the foregoing proceedings will not have a material adverse effect, either individually or in the aggregate, on our financial condition, results of operations or cash flows.

On April 25, 2017 and October 11, 2018, the company met with representatives from multiple California municipality district attorney offices as part of an informal inquiry by those offices into the handling, storage and disposal of certain types of hazardous waste at our store locations in those municipalities. We are unable to make a reasonable estimate of the amount or range of loss that could result from an unfavorable outcome in these matters.

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 a 90-day/4,000 mile 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 \$10.1 million as of August 31, 2019, and \$7.4 million as of February 28, 2019, 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, 2019 ("fiscal 2019"), 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 financing to customers buying retail vehicles from CarMax.

#### **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 ("ESPs") and guaranteed asset protection ("GAP"); and vehicle repair service. We offer competitive, no-haggle prices; a broad selection of CarMax Quality Certified used vehicles; value-added EPP products; and superior customer service. Our website and related mobile apps are tools for communicating the CarMax consumer offer in detail; sophisticated search engines for finding the right vehicle; and sales channels for customers who prefer to shop online.

Our customers finance the majority of the retail vehicles purchased from us, and 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 August 31, 2019, we operated 209 used car stores in 103 U.S. television markets. As of that date, we also conducted wholesale auctions at 76 used car stores and we operated 2 new car franchises.

#### **CarMax Auto Finance**

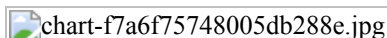
In addition to third-party finance providers, we provide vehicle financing through CAF, which offers financing solely to customers buying retail vehicles from CarMax. CAF allows us to manage our reliance on third-party finance providers and to leverage knowledge of our business to provide qualifying customers a competitive financing option. As a result, we believe CAF enables us to capture additional profits, cash flows and sales. 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 expenses. CAF income does not include any allocation of indirect costs. After the effect of 3-day payoffs and vehicle returns, CAF financed 41.8% of our retail used vehicle unit sales in the first six months of fiscal 2020. As of August 31, 2019, CAF serviced approximately 1,004,000 customer accounts in its \$13.13 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.

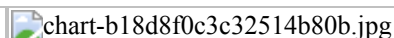
## Revenues and Profitability

The sources of revenue and gross profit from the CarMax Sales Operations segment for the first six months of fiscal 2020 are as follows:

### Net Sales and Operating Revenues



### Gross Profit



A high-level summary of our financial results for the second quarter and first half of fiscal 2020 as compared to the second quarter and first half of fiscal 2019 is as follows:

	Three Months Ended August 31, 2019	Change from Three Months Ended August 31, 2018	Six Months Ended August 31, 2019	Change from Six Months Ended August 31, 2018
<i>(Dollars in millions except per share or per unit data)</i>				
<b>Income statement information</b>				
Net sales and operating revenues	\$ 5,201.2	9.1 %	\$ 10,567.5	10.6 %
Gross profit	\$ 693.5	6.6 %	\$ 1,435.8	9.4 %
CAF income	\$ 114.1	4.1 %	\$ 230.1	2.1 %
Selling, general and administrative expenses	\$ 480.8	6.0 %	\$ 970.5	8.8 %
Net earnings	\$ 233.6	5.8 %	\$ 500.3	8.9 %
<b>Unit sales information</b>				
Used unit sales	209,091	6.2 %	433,359	9.6 %
Change in used unit sales in comparable stores	3.2%	N/A	6.3%	N/A
Wholesale unit sales	126,513	4.7 %	247,281	5.6 %
<b>Per unit information</b>				
Used gross profit per unit	\$ 2,183	0.2 %	\$ 2,200	0.1 %
Wholesale gross profit per unit	\$ 928	1.0 %	\$ 984	2.1 %
SG&A per used vehicle unit	\$ 2,300	(0.2)%	\$ 2,239	(0.8)%
<b>Per share information</b>				
Net earnings per diluted share	\$ 1.40	12.9 %	\$ 2.99	16.3 %

Refer to “Results of Operations” for further details on our revenues and profitability.

## Liquidity

Our primary ongoing sources of liquidity include funds provided by operations, proceeds from non-recourse funding vehicles, and borrowings under our revolving credit facility or through other financing sources. During the first six months of fiscal 2020, net cash used in operations totaled \$125.5 million. This amount, combined with \$606.1 million of net issuances of non-recourse notes payable, resulted in \$480.6 million of adjusted net cash provided by operating activities (a non-GAAP measure). This



liquidity was primarily used to fund the repurchase of 4.5 million common shares under our share repurchase program and our store growth.

When considering cash provided by operating activities, management does not include increases in auto loan receivables that have been funded with non-recourse notes payable, which are separately reflected as cash provided by (used in) financing activities. For a reconciliation of adjusted net cash provided by operating activities to net cash (used in) 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**

Our long-term strategy is to complete the rollout of our retail concept, including our new omni-channel experience, and to increase our share of used vehicle unit sales in each of the markets in which we operate. Our omni-channel experience empowers customers to buy a car on their own terms, whether completely from home, in-store, or through a seamlessly integrated combination of online and in-store experiences. We believe that, over the long term, used vehicle unit sales are the primary driver for earnings growth. 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.

In calendar 2018, we estimate we sold approximately 4.4% of the age 0- to 10-year old vehicles sold in the comparable store markets in which we were operating and approximately 3.3% of the age 0- to 10-year old vehicles sold on a nationwide basis. Our strategy to increase our market share includes continuing to focus on:

- Opening stores in new markets and expanding our presence in existing markets.
- Delivering a customer-driven, omni-channel buying and selling experience that is a unique and powerful integration of our in-store and online capabilities.
- Hiring and developing an engaged and skilled workforce.
- Improving efficiency in our stores and our logistics operations to drive out waste.
- Leveraging data and advanced analytics to continuously improve the customer experience as well as our processes and systems.

In order to execute our long-term strategy, we are investing in various strategic initiatives to increase innovation, specifically with regards to customer facing and customer-enabling technologies. We continue to make improvements to our website and introduce new customer experiences, such as finance pre-approval, home delivery, online appraisal and express pick-up. We are also developing and implementing tools that help our associates be more efficient and effective. Additionally, we are centralizing customer support in our customer experience centers (“CEC”), which we expect to provide a more seamless integration between the online and in-store experience for our customers. Our use of data is a core component of these initiatives and continues to be a strategic asset for us as we leverage data to enhance the customer experience and increase operational efficiencies.

In December 2018, we launched our new omni-channel car buying experience in the Atlanta market, and in the second quarter and first half of fiscal 2020, used unit sales in comparable stores and the appraisal buy rate in this market continued to out-perform full company results. During the second quarter of fiscal 2020, we continued this roll-out to several new markets, including markets in Florida, North Carolina, Virginia and Texas, making the omni-channel experience available to approximately one-third of our customer base. We expect performance in each new omni-channel market will vary. Going forward, we plan to discuss our omni-channel results as a whole rather than on a market-by-market basis. We opened CECs in Atlanta and Kansas City during the second quarter of fiscal 2020, and later this year we plan to open another CEC in Phoenix. We anticipate staffing each of these CECs with more than 300 associates. We remain on track to make the omni-channel experience available to the majority of our customers by the end of fiscal 2020.

While there are incremental costs and inefficiencies in the near term related to strategic initiatives, we have also identified potential cost savings through process changes and other improvements that can help offset these expenses over time. While in any individual period conditions may vary, over the long term, we would expect to leverage our SG&A expenses when comparable store used unit sales growth is in the mid-single digit range. With increased spending expected for fiscal 2020, we believe our comparable store used unit sales growth will need to be in the range of 5% to 8% to leverage SG&A. We expect the rate of growth in spending on these initiatives to slow in fiscal 2021 and taper thereafter. We will continue to look for opportunities to reduce waste and re-prioritize spend.

As of August 31, 2019, we had used car stores located in 103 U.S. television markets, which covered approximately 77% of the U.S. population. The format and operating models utilized in stores are continuously evaluated and may change or evolve over time based upon market and consumer expectations. During the first six months of fiscal 2020, we opened six stores, and during the remainder of the fiscal year, we plan to open seven stores. In fiscal 2021, we plan to open a similar number of stores as we

expect to open in fiscal 2020. For a detailed list of stores we plan to open in the 12 months following August 31, 2019, see the table included in “PLANNED FUTURE ACTIVITIES.”

While we execute our long-term strategy, there are trends and factors that could impact our strategic approach or our results in the short and medium term. For additional information about risks and uncertainties facing our company, see “Risk Factors,” included in Part I. Item 1A of the Annual Report on Form 10-K for the fiscal year ended February 28, 2019.

## 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, 2019.

## RESULTS OF OPERATIONS – CARMAX SALES OPERATIONS

### NET SALES AND OPERATING REVENUES

<i>(In millions)</i>	Three Months Ended August 31			Six Months Ended August 31		
	2019	2018	Change	2019	2018	Change
Used vehicle sales	\$ 4,346.3	\$ 3,975.4	9.3 %	\$ 8,887.0	\$ 7,996.4	11.1 %
Wholesale vehicle sales	678.3	628.0	8.0 %	1,340.7	1,245.6	7.6 %
Other sales and revenues:						
Extended protection plan revenues	113.3	98.5	15.0 %	224.6	198.6	13.1 %
Third-party finance fees, net	(10.3)	(9.7)	(6.6)%	(25.8)	(24.2)	(6.8)%
Other	73.6	73.9	(0.4)%	141.0	142.2	(0.9)%
Total other sales and revenues	176.6	162.7	8.5 %	339.8	316.6	7.3 %
Total net sales and operating revenues	\$ 5,201.2	\$ 4,766.0	9.1 %	\$ 10,567.5	\$ 9,558.6	10.6 %

### UNIT SALES

	Three Months Ended August 31			Six Months Ended August 31		
	2019	2018	Change	2019	2018	Change
Used vehicles	209,091	196,880	6.2%	433,359	395,278	9.6%
Wholesale vehicles	126,513	120,866	4.7%	247,281	234,201	5.6%

### AVERAGE SELLING PRICES

	Three Months Ended August 31			Six Months Ended August 31		
	2019	2018	Change	2019	2018	Change
Used vehicles	\$ 20,581	\$ 20,005	2.9%	\$ 20,306	\$ 20,036	1.3%
Wholesale vehicles	\$ 5,090	\$ 4,955	2.7%	\$ 5,150	\$ 5,076	1.5%

### COMPARABLE STORE USED VEHICLE SALES CHANGES

	Three Months Ended August 31 <sup>(1)</sup>		Six Months Ended August 31 <sup>(1)</sup>	
	2019	2018	2019	2018
Used vehicle units	3.2%	2.1%	6.3%	(0.2)%
Used vehicle revenues	6.3%	3.8%	7.9%	2.2 %

<sup>(1)</sup> 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 Ended August 31		Six Months Ended August 31	
	2019	2018	2019	2018
Used vehicle units	<b>6.2%</b>	5.8%	<b>9.6%</b>	3.7%
Used vehicle revenues	<b>9.3%</b>	7.6%	<b>11.1%</b>	6.1%
Wholesale vehicle units	<b>4.7%</b>	14.6%	<b>5.6%</b>	12.1%
Wholesale vehicle revenues	<b>8.0%</b>	14.6%	<b>7.6%</b>	13.1%

## USED VEHICLE FINANCING PENETRATION BY CHANNEL (BEFORE THE IMPACT OF 3-DAY PAYOFFS)

	Three Months Ended August 31 <sup>(1)</sup>		Six Months Ended August 31 <sup>(1)</sup>	
	2019	2018	2019	2018
CAF <sup>(2)</sup>	<b>46.8%</b>	49.3%	<b>46.5%</b>	48.8%
Tier 2 <sup>(3)</sup>	<b>19.7%</b>	17.0%	<b>20.0%</b>	17.0%
Tier 3 <sup>(4)</sup>	<b>9.6%</b>	8.8%	<b>10.6%</b>	9.9%
Other <sup>(5)</sup>	<b>23.9%</b>	24.9%	<b>22.9%</b>	24.3%
Total	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%

<sup>(1)</sup> Calculated as used vehicle units financed for respective channel as a percentage of total used units sold.

<sup>(2)</sup> Includes CAF's Tier 3 loan originations, which represent less than 1% of total used units sold.

<sup>(3)</sup> Third-party finance providers who generally pay us a fee or to whom no fee is paid.

<sup>(4)</sup> Third-party finance providers to whom we pay a fee.

<sup>(5)</sup> Represents customers arranging their own financing and customers that do not require financing.

## CHANGE IN USED CAR STORE BASE

	Three Months Ended August 31		Six Months Ended August 31	
	2019	2018	2019	2018
Used car stores, beginning of period	<b>206</b>	191	<b>203</b>	188
Store openings	<b>3</b>	3	<b>6</b>	6
Used car stores, end of period	<b>209</b>	194	<b>209</b>	194

During the first six months of fiscal 2020, we opened six stores, including three stores in new television markets (Waco, TX; McAllen, TX; and Lubbock, TX) and three stores in existing television markets (Memphis, TN; San Francisco, CA; and Phoenix, AZ).

**Used Vehicle Sales.** The 9.3% increase in used vehicle revenues in the second quarter of fiscal 2020 was primarily due to a 6.2% increase in used unit sales. The increase in used units included a 3.2% increase in comparable store used unit sales and sales from newer stores not yet included in the comparable store base. The comparable store used unit sales performance primarily reflected strong conversion as well as a 16% increase in website traffic.

The 11.1% increase in used vehicle revenues in the first half of fiscal 2020 was primarily due to a 9.6% increase in used unit sales. The increase in used units included a 6.3% increase in comparable store used unit sales and sales from newer stores not yet included in the comparable store base. The comparable store used unit sales performance primarily reflected strong conversion as well as a 15% increase in website traffic.

We believe that solid execution by our store teams and the impacts of our initiatives to enhance the customer experience, as well as increased conversion by our Tier 2 and Tier 3 providers, contributed to our continued improvements in conversion in both the second quarter and first half of fiscal 2020.

The increase in average retail selling price in both the second quarter and first half of fiscal 2020 reflected higher vehicle acquisition costs as well as shifts in the mix of our sales by both vehicle age and class.



**Wholesale Vehicle Sales.** Vehicles sold at our wholesale auctions are, on average, approximately 10 years old with more than 100,000 miles and are primarily vehicles purchased through our appraisal process that do not meet our retail standards. Our wholesale auction prices usually reflect 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 being sold.

The 8.0% increase in wholesale vehicle revenues in the second quarter of fiscal 2020 was primarily due to a 4.7% increase in unit sales. The wholesale unit growth was largely driven by an increase in our appraisal buy rate, partially offset by lower appraisal traffic.

The 7.6% increase in wholesale vehicle revenues in the first half of fiscal 2020 was primarily due to a 5.6% increase in unit sales. The wholesale unit growth was largely driven by an increase in our appraisal buy rate and the growth in our store base, partially offset by lower appraisal traffic.

**Other Sales and Revenues.** Other sales and revenues include revenue from the sale of ESPs and GAP (collectively reported in EPP revenues, net of a reserve for estimated contract cancellations), net third-party finance fees, and other revenues, which are predominantly comprised of service department and new vehicle sales. 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, or customers that arrange their own financing, 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 8.5% in the second quarter of fiscal 2020. EPP revenues increased 15.0%, reflecting the combined effects of our used unit growth, increased margin and higher product penetration rates. In addition, we recognized a \$6.5 million benefit for estimated ESP profit-sharing revenues compared with a \$4.4 million benefit recognized in the prior year quarter. Net third-party finance fees were comparable with the prior year period.

Other sales and revenues increased 7.3% in the first half of fiscal 2020. EPP revenues increased 13.1%, reflecting the combined effects of our used unit growth, increased margin and higher product penetration rates. Net third-party finance fees declined \$1.6 million, reflecting shifts in our sales mix by finance channel.

We expect to begin receiving ESP profit-sharing payments in the first calendar quarter of 2020 and the initial payment could be up to \$50 million. Through August 31, 2019, we have recognized revenue of \$32.2 million, which represents the cumulative amount for which we have determined it is probable it will not result in a significant revenue reversal. The first payment reflects the accumulation of profit-sharing for four years under our current contracts with the providers, while any subsequent profit-sharing payments we receive will only reflect one year of incremental earnings.

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

## GROSS PROFIT

<i>(In millions)</i>	Three Months Ended August 31			Six Months Ended August 31		
	2019	2018	Change	2019	2018	Change
Used vehicle gross profit	\$ 456.4	\$ 429.0	6.4%	\$ 953.2	\$ 868.4	9.8%
Wholesale vehicle gross profit	117.4	111.1	5.7%	243.3	225.8	7.8%
Other gross profit	119.7	110.5	8.2%	239.3	217.8	9.9%
Total	\$ 693.5	\$ 650.6	6.6%	\$ 1,435.8	\$ 1,312.0	9.4%

## GROSS PROFIT PER UNIT

	Three Months Ended August 31				Six Months Ended August 31			
	2019		2018		2019		2018	
	\$ per unit <sup>(1)</sup>	% <sup>(2)</sup>	\$ per unit <sup>(1)</sup>	% <sup>(2)</sup>	\$ per unit <sup>(1)</sup>	% <sup>(2)</sup>	\$ per unit <sup>(1)</sup>	% <sup>(2)</sup>
Used vehicle gross profit	\$ 2,183	10.5	\$ 2,179	10.8	\$ 2,200	10.7	\$ 2,197	10.9
Wholesale vehicle gross profit	\$ 928	17.3	\$ 919	17.7	\$ 984	18.1	\$ 964	18.1
Other gross profit	\$ 572	67.8	\$ 562	68.0	\$ 552	70.4	\$ 551	68.8
Total gross profit	\$ 3,317	13.3	\$ 3,305	13.7	\$ 3,313	13.6	\$ 3,319	13.7

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

<sup>(2)</sup> 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 dollars per unit.

We systematically adjust 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 the wholesale and retail vehicle pricing environments, vehicle reconditioning and logistics costs, and the percentage of vehicles sourced directly from consumers through our appraisal process. Vehicles purchased directly from consumers typically generate more gross profit per unit compared with vehicles purchased at auction or through other channels.

Used vehicle gross profit rose 6.4% in the second quarter of fiscal 2020 and 9.8% in the first half of fiscal 2020, driven by the 6.2% and 9.6% growth in total used unit sales, respectively. Our used vehicle gross profit per unit was consistent with the corresponding prior year quarter and period. We believe we can manage to a targeted gross profit per unit dollar range, subject to future changes to our business or pricing strategy.

**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 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 the wholesale pricing environment is a key factor that influences wholesale gross profit.

Wholesale vehicle gross profit increased 5.7% in the second quarter of fiscal 2020, driven by the 4.7% increase in wholesale unit sales and a \$9 increase in wholesale gross profit per unit. In the first half of fiscal 2020, wholesale vehicle gross profit increased 7.8%, driven by the 5.6% increase in wholesale unit sales and a \$20 increase in wholesale gross profit per unit.

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

Other gross profit rose 8.2% in the second quarter of fiscal 2020 and 9.9% in the first half of fiscal 2020, primarily reflecting the changes 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, we believe higher vehicle acquisition prices have adversely impacted, and could impact in the future, our comparable store used unit sales growth. Changes in average vehicle selling prices also impact CAF income, to the extent the average amount financed also changes.

## SG&A Expenses

### COMPONENTS OF SG&A EXPENSES AS A PERCENTAGE OF TOTAL SG&A EXPENSES



### COMPONENTS OF SG&A EXPENSES COMPARED WITH PRIOR PERIOD

<i>(In millions except per unit data)</i>	Three Months Ended August 31			Six Months Ended August 31		
	2019	2018	Change	2019	2018	Change
Compensation and benefits <sup>(1)</sup>	\$ 249.4	\$ 238.9	4.4%	\$ 520.2	\$ 480.3	8.3%
Store occupancy costs	96.7	90.8	6.5%	193.3	178.6	8.2%
Advertising expense	46.8	46.7	0.3%	88.8	85.2	4.2%
Other overhead costs <sup>(2)</sup>	87.9	77.2	13.9%	168.2	147.7	13.9%
<b>Total SG&amp;A expenses</b>	<b>\$ 480.8</b>	<b>\$ 453.6</b>	<b>6.0%</b>	<b>\$ 970.5</b>	<b>\$ 891.8</b>	<b>8.8%</b>
SG&A per used vehicle unit <sup>(3)</sup>	\$ 2,300	\$ 2,304	\$ (4)	\$ 2,239	\$ 2,256	\$ (17)

<sup>(1)</sup> Excludes compensation and benefits related to reconditioning and vehicle repair service, which are included in cost of sales. See Note 10 for details of share-based compensation expense by grant type.

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

<sup>(3)</sup> Calculated as total SG&A expenses divided by total used vehicle units.

SG&A expenses increased 6.0% in the second quarter of fiscal 2020. In addition to the 9% growth in our store base since the beginning of last year's second quarter (representing the addition of 18 stores) and higher costs associated with our comparable store unit growth, the net increase reflected the following:

- \$10.7 million increase in other overhead costs, which included continued spending to advance our technology platforms and support our core and omni-channel strategic initiatives.
- Advertising expense remained consistent with the prior year quarter due to shifts in the timing of our spend. Advertising spending is expected to increase in the second half of fiscal 2020 and for the full year fiscal 2020, as compared to fiscal 2019, as we launch a new advertising campaign and support our omni-channel rollout.

SG&A expenses increased 8.8% in the first half of fiscal 2020. In addition to the 11% growth in our store base since the beginning of fiscal 2019 (representing the addition of 21 stores) and higher costs associated with our comparable store unit growth, the net increase reflected the following:

- \$13.0 million increase in share-based compensation expense. The increase in share-based compensation expense was largely related to cash-settled restricted stock units, as the expense associated with these units was primarily driven by the change in the company's stock price during the relevant periods.
- \$20.5 million increase in other overhead costs, which included continued spending to advance our technology platforms and support our core and omni-channel strategic initiatives.
- Advertising expense increased slightly due to shifts in the timing of our spend. As noted above, advertising spending is expected to increase in the second half of fiscal 2020 and for the full year fiscal 2020, as compared to fiscal 2019.

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

Interest expense rose to \$21.1 million and \$38.9 million in the second quarter and first half of fiscal 2020, respectively, from \$18.0 million and \$36.0 million in the second quarter and first half of fiscal 2019. The increase primarily reflected higher outstanding debt levels in the second quarter and first half of fiscal 2020.

**Income Taxes.** The effective income tax rate was 23.5% in the second quarter of fiscal 2020 and 23.8% in the first half of fiscal 2020 versus 23.7% in the second quarter of fiscal 2019 and 24.6% in the first half of fiscal 2019. The effective tax rate for both the second quarter and first half of fiscal 2020 was positively impacted by share-based awards that settled during the periods.

## RESULTS OF OPERATIONS – CARMAX AUTO FINANCE

CAF income primarily reflects 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. Total interest margin reflects the spread between interest and fees charged to consumers and our funding costs. Changes in the interest margin on new originations affect CAF income over time. Continued increases in interest rates, which affect CAF's funding costs, or other competitive pressures on consumer rates, could result in further compression in the interest margin on new originations. Changes in the allowance for loan losses as a percentage of ending managed receivables reflect the effect of the change in loss and delinquency experience on our outlook for net losses expected to occur over the next 12 months.

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. We strive to originate loans with an underlying risk profile that we believe will, in the aggregate and excluding CAF's Tier 3 originations, result in cumulative net losses in the 2% to 2.5% range over the life of the loans. Actual loss performance of the loans may fall outside of this range based on various factors, including intentional changes in the risk profile of originations, economic conditions and wholesale recovery rates. 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.

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.

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

## SELECTED CAF FINANCIAL INFORMATION

<i>(In millions)</i>	Three Months Ended August 31				Six Months Ended August 31			
	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>	2019	% <sup>(1)</sup>	2018	% <sup>(1)</sup>
Interest margin:								
Interest and fee income	\$ 275.7	8.5	\$ 242.2	8.0	\$ 541.9	8.4	\$ 474.5	8.0
Interest expense	(90.6)	(2.8)	(69.1)	(2.3)	(178.0)	(2.8)	(132.9)	(2.2)
Total interest margin	\$ 185.1	5.7	\$ 173.1	5.7	\$ 363.9	5.7	\$ 341.6	5.7
Provision for loan losses	\$ (45.5)	(1.4)	\$ (40.0)	(1.3)	\$ (83.7)	(1.3)	\$ (70.9)	(1.2)
CarMax Auto Finance income	\$ 114.1	3.5	\$ 109.7	3.6	\$ 230.1	3.6	\$ 225.3	3.8

<sup>(1)</sup> Annualized percentage of total average managed receivables.

## CAF ORIGINATION INFORMATION (AFTER THE IMPACT OF 3-DAY PAYOFFS)

	Three Months Ended August 31		Six Months Ended August 31	
	2019	2018	2019	2018
Net loans originated (in millions)	\$ 1,772.6	\$ 1,678.4	\$ 3,598.9	\$ 3,343.9
Vehicle units financed	88,285	86,399	181,243	171,496
Net penetration rate <sup>(1)</sup>	42.2%	43.9%	41.8%	43.4%
Weighted average contract rate	8.6%	8.5%	8.7%	8.4%
Weighted average credit score <sup>(2)</sup>	708	707	706	705
Weighted average loan-to-value (LTV) <sup>(3)</sup>	94.7%	95.2%	94.5%	95.1%
Weighted average term (in months)	66.2	66.0	66.2	66.0

<sup>(1)</sup> Vehicle units financed as a percentage of total used units sold.

<sup>(2)</sup> 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.

<sup>(3)</sup> 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.

## LOAN PERFORMANCE INFORMATION

(In millions)	As of and for the Three Months Ended August 31		As of and for the Six Months Ended August 31	
	2019	2018	2019	2018
Total ending managed receivables	\$ 13,131.5	\$ 12,214.1	\$ 13,131.5	\$ 12,214.1
Total average managed receivables	\$ 13,012.1	\$ 12,067.5	\$ 12,859.7	\$ 11,921.4
Allowance for loan losses <sup>(1)</sup>	\$ 150.4	\$ 138.1	\$ 150.4	\$ 138.1
Allowance for loan losses as a percentage of ending managed receivables	1.15%	1.13%	1.15%	1.13%
Net credit losses on managed receivables	\$ 42.1	\$ 36.2	\$ 71.5	\$ 61.4
Annualized net credit losses as a percentage of total average managed receivables	1.29%	1.20%	1.11%	1.03%
Past due accounts as a percentage of ending managed receivables	3.55%	3.43%	3.55%	3.43%
Average recovery rate <sup>(2)</sup>	48.6%	47.9%	48.9%	47.8%

<sup>(1)</sup> 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.

<sup>(2)</sup> 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. While in any individual period conditions may vary, over the past 10 fiscal years, the annual recovery rate has ranged from a low of 46% to a high of 60%, and it is primarily affected by the wholesale market environment.

- CAF Income (Increase of \$4.5 million, or 4.1%, and \$4.8 million, or 2.1%, in the second quarter and first half of fiscal 2020, respectively)
  - The increase in CAF income for both the second quarter and first half of fiscal 2020 reflects an increase in average managed receivables, partially offset by an increase in the provision for loan losses.
  - Average managed receivables grew 7.8% to \$13.01 billion in the second quarter of fiscal 2020 and 7.9% to \$12.86 billion in the first half of fiscal 2020 driven primarily by the rise in CAF loan originations in recent years.
  - The growth in net loan originations in both the second quarter and first half of fiscal 2020 resulted from our used vehicle sales growth and an increase in the average amount financed, partially offset by a decline in CAF's penetration rate.

- Provision for Loan Losses (Increased to \$45.5 million and \$83.7 million in the second quarter and first half of fiscal 2020, respectively, from \$40.0 million and \$70.9 million in the second quarter and first half of fiscal 2019)
  - The increase in the provision for loan losses was primarily due to the growth in average managed receivables as well as a slight increase in the allowance as a percentage of managed receivables.
  - The allowance for loan losses as a percentage of ending managed receivables was 1.15% as of August 31, 2019, compared with 1.13% as of August 31, 2018, and 1.10% as of February 28, 2019.
  - Net losses for both the second quarter and first half of fiscal 2020 remained well within our long-term targeted performance range.
- Total interest margin remained flat at 5.7% of average managed receivables in both the second quarter and first half of fiscal 2020.

**Tier 3 Loan Originations.** CAF also originates a small portion of auto loans to customers who typically would be financed by our Tier 3 finance providers, in order to better understand the performance of these loans, mitigate risk and add incremental profits. CAF currently targets originating approximately 5% of the total Tier 3 loan volume; however, this rate may vary over time based on market conditions. A total of \$170.0 million and \$162.4 million in CAF Tier 3 receivables were outstanding as of August 31, 2019 and February 28, 2019, respectively. These loans have higher loss and delinquency rates than the remainder of the CAF portfolio, as well as higher contract rates. As of August 31, 2019 and February 28, 2019, approximately 10% of the total allowance for loan losses related to the outstanding CAF Tier 3 loan balances.

### PLANNED FUTURE ACTIVITIES

We currently plan to open 13 stores in fiscal 2020 and a similar number of stores in fiscal 2021. During the second quarter of fiscal 2020, we opened CECs in Atlanta and Kansas City and plan to open another CEC later this year. We currently estimate capital expenditures will total approximately \$350 million in fiscal 2020.

We currently plan to open the following stores within 12 months from August 31, 2019. During this period, we will be entering three new television markets and expanding our presence in ten existing television markets. Of the 13 stores we plan to open during the 12 months ending August 31, 2020, 5 will be in Metropolitan Statistical Areas having populations of 600,000 or less, which we define as small markets. Normal construction, permitting or other scheduling delays could shift the opening dates of any of these stores into a later period.

### PLANNED STORE OPENINGS – NEXT 12 MONTHS

Location	Television Market	Metropolitan Statistical Area	Planned Opening Date
Denton, Texas <sup>(1)</sup>	Dallas/Ft. Worth	Dallas/Fort Worth/Arlington	Q3 Fiscal 2020
Palm Desert, California <sup>(1)</sup>	Palm Springs <sup>(2)</sup>	Riverside/San Bernardino/Ontario	Q3 Fiscal 2020
Bogart, Georgia	Atlanta	Athens/Clarke County	Q3 Fiscal 2020
Gulfport, Mississippi	Biloxi/Gulfport <sup>(2)</sup>	Gulfport/Biloxi/Pascagoula	Q3 Fiscal 2020
Fort Wayne, Indiana	Fort Wayne <sup>(2)</sup>	Fort Wayne	Q4 Fiscal 2020
Salem, Oregon	Portland	Salem	Q4 Fiscal 2020
Murfreesboro, Tennessee	Nashville	Nashville/Davidson/Murfreesboro	Q4 Fiscal 2020
Easton, Pennsylvania	Philadelphia	Allentown/Bethlehem/Easton	Q1 Fiscal 2021
Bradenton, Florida	Tampa	North Port/Sarasota/Bradenton	Q1 Fiscal 2021
Canoga Park, California	Los Angeles	Los Angeles	Q1 Fiscal 2021
Covington, Louisiana	New Orleans	New Orleans	Q1 Fiscal 2021
West Palm Beach, Florida	Miami/Ft. Lauderdale/W. Palm Beach	Miami/Ft. Lauderdale/W. Palm Beach	Q2 Fiscal 2021
Jacksonville, N. Carolina	Greenville/New Bern/Washington	Jacksonville	Q2 Fiscal 2021

<sup>(1)</sup> Store opened in September 2019.

<sup>(2)</sup> Represents new television market as of planned store opening date.

## FINANCIAL CONDITION

### Liquidity and Capital Resources.

Our primary ongoing cash requirements are to fund our existing operations, store expansion and improvement and CAF. Since fiscal 2013, we have also elected to use cash for our share repurchase program. Our primary ongoing sources of liquidity include funds provided by operations, proceeds from non-recourse funding vehicles and borrowings under our revolving credit facility or through other financing sources.

We currently target an adjusted debt-to-total capital ratio in a range of 35% to 45%. In calculating this ratio, we utilize total debt excluding non-recourse notes payable, finance lease liabilities, a multiple of eight times rent expense and total shareholders' equity. We expect to use our revolving credit facility and other financing sources, together with stock repurchases, to maintain this targeted ratio; however, in any period, we may be outside this range due to seasonal, market, strategic or other factors.

Operating Activities. During the first six months of fiscal 2020, net cash used in operating activities totaled \$125.5 million, compared with net cash provided by operating activities of \$110.9 million in the prior year period, which included increases in auto loan receivables of \$721.2 million in the current year period and \$675.6 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 from financing activities.

As of August 31, 2019, total inventory was \$2.60 billion, representing an increase of \$85.3 million, or 3.4%, compared with the balance as of the start of the fiscal year. The increase primarily reflected a higher average carrying cost of inventory due to an increase in acquisition costs and changes in our vehicle mix. The impact of adding six new stores to our store base was mostly offset by the seasonal pattern of inventory levels. We typically build inventory in the latter portion of the fiscal year to better position ourselves for seasonal sales opportunities.

When considering cash used in or 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 funded 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

<i>(In millions)</i>	Six Months Ended August 31	
	2019	2018
Net cash (used in) provided by operating activities	\$ (125.5)	\$ 110.9
Add: Net issuances of non-recourse notes payable <sup>(1)</sup>	606.1	607.5
Adjusted net cash provided by operating activities	\$ 480.6	\$ 718.4

<sup>(1)</sup> Calculated using the gross issuances less payments on non-recourse notes payable as disclosed on the consolidated statements of cash flows.

Adjusted net cash provided by operating activities for the first six months of the current fiscal year decreased compared with the prior year period primarily due to the changes in inventory discussed above and timing-related changes to accounts payable and accrued expenses and other current assets, partially offset by an increase in net earnings.

Investing Activities. During the first six months of the fiscal year, net cash used in investing activities totaled \$178.9 million in fiscal 2020 compared with \$174.9 million in fiscal 2019. Capital expenditures were \$171.3 million in the current year period versus \$171.1 million in the prior year period. Capital expenditures primarily included store construction costs, real estate acquisitions for planned future store openings, 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 August 31, 2019, 131 of our 209 used car stores were located on owned sites and 78 were located on leased sites, including 22 land-only leases and 56 land and building leases.

**Financing Activities.** During the first six months of fiscal 2020, net cash provided by financing activities totaled \$346.6 million compared with \$108.3 million in the prior year period. Included in these amounts were net increases in total non-recourse notes payable of \$606.1 million and \$607.5 million, respectively, which were used to provide the financing for the majority of the increases of \$721.2 million and \$675.6 million, respectively, in auto loan receivables (see “Operating Activities”).

During the first six months of fiscal 2020, cash provided by financing activities was impacted by stock repurchases of \$341.9 million as well as net borrowings on our long-term debt of \$8.6 million. During the first six months of fiscal 2019, cash provided by financing activities was impacted by stock repurchases of \$381.3 million as well as net repayments on our long-term debt of \$160.0 million.

#### TOTAL DEBT AND CASH AND CASH EQUIVALENTS

<i>(In thousands)</i>		<b>As of August 31</b>	<b>As of February 28</b>
<b>Debt Description <sup>(1)</sup></b>	<b>Maturity Date</b>	<b>2019</b>	<b>2019</b>
Revolving credit facility <sup>(2)</sup>	June 2024	\$ 379,515	\$ 366,529
Term loan <sup>(2)</sup>	June 2024	300,000	300,000
3.86% Senior notes	April 2023	100,000	100,000
4.17% Senior notes	April 2026	200,000	200,000
4.27% Senior notes	April 2028	200,000	200,000
Financing obligations	Various dates through February 2059	522,897	495,626
Non-recourse notes payable	Various dates through January 2026	13,141,504	12,535,405
<b>Total debt <sup>(3)</sup></b>		<b>14,843,916</b>	<b>14,197,560</b>
Cash and cash equivalents		\$ 40,737	\$ 46,938

<sup>(1)</sup> Interest is payable monthly, with the exception of our senior notes, which are payable semi-annually.

<sup>(2)</sup> Borrowings accrue interest at variable rates based on the Eurodollar rate (LIBOR), the federal funds rate, or the prime rate, depending on the type of borrowing.

<sup>(3)</sup> Total debt excludes unamortized debt issuance costs. See Note 9 for additional information.

Borrowings under our \$1.45 billion unsecured revolving credit facility are available for working capital and general corporate purposes, and the unused portion is fully available to us. The credit facility, term loan and senior note agreements contain representations and warranties, conditions and covenants. If these requirements are 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.

See Note 9 for additional information on our revolving credit facility, term loan, senior notes and financing obligations.

CAF auto loan receivables are primarily funded through our warehouse facilities and asset-backed term funding transactions. These non-recourse funding vehicles are structured to legally isolate the auto loan receivables, and we would not expect to be able to access the assets of our non-recourse funding 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 related 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 non-recourse funding vehicles.

As of August 31, 2019, \$10.88 billion and \$2.26 billion of non-recourse notes payable were outstanding related to asset-backed term funding transactions and our warehouse facilities, respectively. During the first six months of fiscal 2020, we funded a total of \$2.87 billion in asset-backed term funding transactions.

We have periodically increased our warehouse facility limit over time, as our store base, sales and CAF loan originations have grown. See Note 9 for additional information on the warehouse facilities.

We generally repurchase the receivables funded through our warehouse facilities when we enter into an asset-backed term funding transaction. If our counterparties were to refuse to permit these repurchases it could impact our ability to execute on our funding program. Additionally, the 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 fund 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 related 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, borrowings under existing, new or expanded credit facilities and other funding arrangements 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.

The timing and amount of stock 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 August 31, 2019, a total of \$2 billion of board authorizations for repurchases were outstanding, with no expiration date, of which \$1.78 billion remained available for repurchase. See Note 10 for more information on share repurchase activity.

**Fair Value Measurements.** We recognize 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, capital structure, opportunities, or prospects, including without limitation any statements or factors regarding expected sales, margins, expenditures, CAF income, stock repurchases, indebtedness, tax rates, earnings, or market conditions 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 the use of words such as “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “outlook,” “plan,” “predict,” “should,” “will” and other 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.
- Our inability to realize the benefits associated with our omni-channel initiatives.
- Changes in the availability or cost of capital and working capital financing, including changes related to the asset-backed securitization market.
- 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, associate or corporate information.
- Significant changes in prices of new and used vehicles.
- Changes in economic conditions or other factors that result in greater credit losses for CAF’s portfolio of auto loan receivables than anticipated.
- A reduction in the availability of or access to sources of inventory or a failure to expeditiously liquidate inventory.
- Changes in consumer credit availability provided by our third-party finance providers.
- Changes in the availability of extended protection plan products from third-party providers.
- Factors related to the regulatory and legislative environment in which we operate.
- Factors related to geographic and sales growth, including the inability to effectively manage our growth.
- The failure of or inability to sufficiently enhance 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.
- The volatility in the market price for our common stock.
- The performance of third-party vendors we rely on for key components of our business.
- Factors related to 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, 2019, 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 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, 2019. 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, 2019.

### 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 August 31, 2019, 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 15 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, 2019, 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

On October 23, 2018, the board authorized the repurchase of up to \$2 billion of our common stock with no expiration date. 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 second quarter of fiscal 2020. The table does not include transactions related to employee equity awards or the exercise of employee stock options.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
June 1 - 30, 2019	521,569	\$ 82.28	521,569	\$ 1,866,191,634
July 1 - 31, 2019	408,734	\$ 87.41	408,734	\$ 1,830,465,327
August 1 - 31, 2019	595,237	\$ 83.49	595,237	\$ 1,780,767,071
<b>Total</b>	<b>1,525,540</b>		<b>1,525,540</b>	

Item 6. Exhibits

- [10.1](#) Credit Agreement, dated as of June 7, 2019, among CarMax Auto Superstores, Inc., CarMax, Inc., certain subsidiaries of CarMax named therein, Bank of America, N.A., as a lender and as administrative agent, and the other lending institutions named therein, filed as Exhibit 10.1 to CarMax's Current Report on Form 8-K, filed June 11, 2019.
- [10.2](#) CarMax, Inc. 2002 Stock Incentive Plan, as amended and restated June 25, 2019, filed as Exhibit 10.1 to CarMax's Current Report on Form 8-K, filed June 26, 2019.
- [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.INS XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- 104 Cover Page Interactive Data File - the cover page XBRL tags are embedded within the Inline XBRL 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/ William D. Nash  
William D. Nash  
President and  
Chief Executive Officer

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

October 4, 2019