

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, 2020

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:

Title of each class

Common Stock

Trading Symbol(s)

KMX

Name of each exchange on which registered

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

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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 Exchange Act). Yes  No

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

Class  
Common Stock, par value \$0.50

Outstanding as of September 30, 2020  
164,086,883

## 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			
	2020	% <sup>(1)</sup>	2019	% <sup>(1)</sup>	2020	% <sup>(1)</sup>	2019	% <sup>(1)</sup>
<b>SALES AND OPERATING REVENUES:</b>								
Used vehicle sales	\$ 4,389,233	81.7	\$ 4,346,295	83.6	\$ 7,175,435	83.4	\$ 8,886,952	84.1
Wholesale vehicle sales	819,082	15.2	678,286	13.0	1,161,934	13.5	1,340,735	12.7
Other sales and revenues	163,851	3.0	176,570	3.4	263,579	3.1	339,782	3.2
<b>NET SALES AND OPERATING REVENUES</b>	<b>5,372,166</b>	<b>100.0</b>	<b>5,201,151</b>	<b>100.0</b>	<b>8,600,948</b>	<b>100.0</b>	<b>10,567,469</b>	<b>100.0</b>
<b>COST OF SALES:</b>								
Used vehicle cost of sales	3,908,065	72.7	3,889,917	74.8	6,432,741	74.8	7,933,741	75.1
Wholesale vehicle cost of sales	674,712	12.6	560,906	10.8	955,634	11.1	1,097,396	10.4
Other cost of sales	37,246	0.7	56,875	1.1	106,247	1.2	100,496	1.0
<b>TOTAL COST OF SALES</b>	<b>4,620,023</b>	<b>86.0</b>	<b>4,507,698</b>	<b>86.7</b>	<b>7,494,622</b>	<b>87.1</b>	<b>9,131,633</b>	<b>86.4</b>
<b>GROSS PROFIT</b>	<b>752,143</b>	<b>14.0</b>	<b>693,453</b>	<b>13.3</b>	<b>1,106,326</b>	<b>12.9</b>	<b>1,435,836</b>	<b>13.6</b>
<b>CARMAX AUTO FINANCE INCOME</b>	<b>147,195</b>	<b>2.7</b>	<b>114,131</b>	<b>2.2</b>	<b>198,145</b>	<b>2.3</b>	<b>230,090</b>	<b>2.2</b>
Selling, general and administrative expenses	490,208	9.1	480,831	9.2	863,924	10.0	970,491	9.2
Interest expense	22,469	0.4	21,073	0.4	46,427	0.5	38,857	0.4
Other (income) expense	(1,680)	—	143	—	1,615	—	(216)	—
Earnings before income taxes	388,341	7.2	305,537	5.9	392,505	4.6	656,794	6.2
Income tax provision	91,645	1.7	71,938	1.4	90,831	1.1	156,451	1.5
<b>NET EARNINGS</b>	<b>\$ 296,696</b>	<b>5.5</b>	<b>\$ 233,599</b>	<b>4.5</b>	<b>\$ 301,674</b>	<b>3.5</b>	<b>\$ 500,343</b>	<b>4.7</b>
<b>WEIGHTED AVERAGE COMMON SHARES:</b>								
Basic	163,434		165,354		163,053		165,839	
Diluted	165,623		167,272		164,580		167,458	
<b>NET EARNINGS PER SHARE:</b>								
Basic	\$ 1.82		\$ 1.41		\$ 1.85		\$ 3.02	
Diluted	\$ 1.79		\$ 1.40		\$ 1.83		\$ 2.99	

<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		Six Months Ended August 31	
	2020	2019	2020	2019
<b>NET EARNINGS</b>	<b>\$ 296,696</b>	<b>\$ 233,599</b>	<b>\$ 301,674</b>	<b>\$ 500,343</b>
Other comprehensive income (loss), net of taxes:				
Net change in retirement benefit plan unrecognized actuarial losses	728	356	1,456	711
Net change in cash flow hedge unrecognized losses	4,251	(10,780)	(11,811)	(24,331)
Other comprehensive income (loss), net of taxes	4,979	(10,424)	(10,355)	(23,620)
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$ 301,675</b>	<b>\$ 223,175</b>	<b>\$ 291,319</b>	<b>\$ 476,723</b>

*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 2020	As of February 29 2020
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 711,561	\$ 58,211
Restricted cash from collections on auto loans receivable	520,876	481,043
Accounts receivable, net	203,155	191,090
Inventory	2,824,959	2,846,416
Other current assets	67,308	86,927
<b>TOTAL CURRENT ASSETS</b>	<b>4,327,859</b>	<b>3,663,687</b>
Auto loans receivable, net of allowance for loan losses of \$432,546 and \$157,796 as of August 31, 2020 and February 29, 2020, respectively	13,013,106	13,551,711
Property and equipment, net of accumulated depreciation of \$1,342,321 and \$1,266,920 as of August 31, 2020 and February 29, 2020, respectively	3,044,773	3,069,102
Deferred income taxes	133,749	89,842
Operating lease assets	444,158	449,094
Other assets	282,661	258,746
<b>TOTAL ASSETS</b>	<b>\$ 21,246,306</b>	<b>\$ 21,082,182</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 683,715	\$ 737,144
Accrued expenses and other current liabilities	350,185	331,738
Accrued income taxes	64,734	1,389
Current portion of operating lease liabilities	31,616	30,980
Short-term debt	838	40
Current portion of long-term debt	10,005	9,251
Current portion of non-recourse notes payable	457,849	424,165
<b>TOTAL CURRENT LIABILITIES</b>	<b>1,598,942</b>	<b>1,534,707</b>
Long-term debt, excluding current portion	1,896,784	1,778,672
Non-recourse notes payable, excluding current portion	12,900,984	13,165,384
Operating lease liabilities, excluding current portion	435,113	440,671
Other liabilities	431,923	393,873
<b>TOTAL LIABILITIES</b>	<b>17,263,746</b>	<b>17,313,307</b>
Commitments and contingent liabilities		
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock, \$0.50 par value; 350,000,000 shares authorized; 164,162,253 and 163,081,376 shares issued and outstanding as of August 31, 2020 and February 29, 2020, respectively	82,081	81,541
Capital in excess of par value	1,460,300	1,348,988
Accumulated other comprehensive loss	(160,426)	(150,071)
Retained earnings	2,600,605	2,488,417
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>3,982,560</b>	<b>3,768,875</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 21,246,306</b>	<b>\$ 21,082,182</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>2020</b>	<b>2019</b>
<b>OPERATING ACTIVITIES:</b>		
Net earnings	\$ 301,674	\$ 500,343
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	118,967	103,468
Share-based compensation expense	62,794	68,887
Provision for loan losses	147,977	83,693
Provision for cancellation reserves	35,678	45,471
Deferred income tax provision	8,598	3,812
Other	5,098	3,718
Net (increase) decrease in:		
Accounts receivable, net	(12,065)	(1,241)
Inventory	21,457	(85,295)
Other current assets	19,691	(48,452)
Auto loans receivable, net	188,601	(721,165)
Other assets	(6,586)	15,421
Net increase (decrease) in:		
Accounts Payable, accrued expenses and other current liabilities and accrued income taxes	24,912	(26,632)
Other liabilities	(27,020)	(67,484)
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>889,776</b>	<b>(125,456)</b>
<b>INVESTING ACTIVITIES:</b>		
Capital expenditures	(91,998)	(171,347)
Proceeds from disposal of property and equipment	826	3
Purchases of investments	(2,566)	(8,244)
Sales of investments	1,381	720
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(92,357)</b>	<b>(178,868)</b>
<b>FINANCING ACTIVITIES:</b>		
Increase (decrease) in short-term debt, net	798	(214)
Proceeds from issuances of long-term debt	1,542,500	3,293,500
Payments on long-term debt	(1,425,084)	(3,284,866)
Cash paid for debt issuance costs	(8,037)	(10,862)
Payments on finance lease obligations	(2,880)	(1,694)
Issuances of non-recourse notes payable	4,798,000	5,748,000
Payments on non-recourse notes payable	(5,028,898)	(5,141,901)
Repurchase and retirement of common stock	(54,151)	(341,929)
Equity issuances	91,724	86,521
<b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>	<b>(86,028)</b>	<b>346,555</b>
Increase in cash, cash equivalents, and restricted cash	711,391	42,231
Cash, cash equivalents, and restricted cash at beginning of year	656,390	595,377
<b>CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT END OF PERIOD</b>	<b>\$ 1,367,781</b>	<b>\$ 637,608</b>
<b>RECONCILIATION OF CASH, CASH EQUIVALENTS AND RESTRICTED CASH TO THE CONSOLIDATED BALANCE SHEETS:</b>		
Cash and cash equivalents	\$ 711,561	\$ 40,737
Restricted cash from collections on auto loans receivable	520,876	483,374
Restricted cash included in other assets	135,344	113,497
<b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH AT END OF PERIOD</b>	<b>\$ 1,367,781</b>	<b>\$ 637,608</b>

*See accompanying notes to consolidated financial statements.*

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

Six Months Ended August 31, 2020

<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 29, 2020</b>	<b>163,081</b>	<b>\$ 81,541</b>	<b>\$ 1,348,988</b>	<b>\$ 2,488,417</b>	<b>\$ (150,071)</b>	<b>\$ 3,768,875</b>
Net earnings	—	—	—	4,978	—	4,978
Other comprehensive loss	—	—	—	—	(15,334)	(15,334)
Share-based compensation expense	—	—	17,652	—	—	17,652
Repurchases of common stock	(515)	(258)	(4,271)	(36,180)	—	(40,709)
Exercise of common stock options	35	18	1,688	—	—	1,706
Stock incentive plans, net shares issued	154	77	(5,629)	—	—	(5,552)
Adoption of CECL	—	—	—	(153,306)	—	(153,306)
<b>Balance as of May 31, 2020</b>	<b>162,755</b>	<b>\$ 81,378</b>	<b>\$ 1,358,428</b>	<b>\$ 2,303,909</b>	<b>\$ (165,405)</b>	<b>\$ 3,578,310</b>
Net earnings	—	—	—	296,696	—	296,696
Other comprehensive income	—	—	—	—	4,979	4,979
Share-based compensation expense	—	—	12,568	—	—	12,568
Repurchases of common stock	—	—	—	—	—	—
Exercise of common stock options	1,403	701	89,318	—	—	90,019
Stock incentive plans, net shares issued	4	2	(14)	—	—	(12)
<b>Balance as of August 31, 2020</b>	<b>164,162</b>	<b>\$ 82,081</b>	<b>\$ 1,460,300</b>	<b>\$ 2,600,605</b>	<b>\$ (160,426)</b>	<b>\$ 3,982,560</b>

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

**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>	<b>\$ 3,357,028</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>

*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 nation’s largest and most profitable 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.

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. Our omni-channel experience, which gives us the largest addressable market in the used car industry, empowers customers to buy a car on their terms – online, in-store or a seamless integration of both. Customers can choose to complete the car-buying experience in-person at one of our stores; or buy the car online and receive delivery through contactless curbside pickup, available nationwide, or home delivery, available to most customers. We offer customers 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 or virtual 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 29, 2020 (the “2020 Annual Report”), with the exception of those related to recent accounting pronouncements adopted in the current fiscal year as disclosed in the company’s Quarterly Report on Form 10-Q for the period ended May 31, 2020 (the “first quarter 2021 10-Q”). These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in our 2020 Annual Report and the unaudited consolidated financial statements and footnotes included in our first quarter 2021 10-Q.

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. In particular, the novel coronavirus (“COVID-19”) pandemic and the resulting adverse impacts to global economic conditions, as well as our operations, may impact future estimates including, but not limited to, our allowance for loan losses, inventory valuations, fair value measurements, downward adjustments to investments in equity securities, asset impairment charges, the effectiveness of the company’s hedging instruments, deferred tax valuation allowances, cancellation reserves, actuarial losses on our retirement benefit plans and discount rate assumptions. Certain prior year amounts have been reclassified to conform to the current year’s presentation. Amounts and percentages may not total due to rounding.

***Recent Accounting Pronouncements.***  
***Effective in Future Periods.***

In August 2020, the Financial Accounting Standards Board (“FASB”) issued an accounting pronouncement (ASU 2020-06) related to the measurement and disclosure requirements for convertible instruments and contracts in an entity’s own equity. The pronouncement simplifies and adds disclosure requirements for the accounting and measurement of convertible instruments and the settlement assessment for contracts in an entity’s own equity. This pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2021. We plan to adopt this pronouncement for our fiscal year beginning March 1, 2022, and we do not expect it to have a material effect on our consolidated financial statements.



## 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	
	2020	2019	2020	2019
Used vehicle sales	\$ 4,389.2	\$ 4,346.3	\$ 7,175.4	\$ 8,887.0
Wholesale vehicle sales	819.1	678.3	1,161.9	1,340.7
Other sales and revenues:				
Extended protection plan revenues	119.4	113.3	192.8	224.6
Third-party finance fees, net	(15.4)	(10.3)	(26.2)	(25.8)
Service revenues	26.5	33.4	46.0	67.3
Other	33.4	40.2	51.0	73.7
Total other sales and revenues	163.9	176.6	263.6	339.8
Total net sales and operating revenues	\$ 5,372.2	\$ 5,201.2	\$ 8,600.9	\$ 10,567.5

**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, or refund liability, 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. As of August 31, 2020 and February 29, 2020, no long-term contract asset was recognized related to cumulative profit-sharing payments to which we expect to be entitled.

***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 loans receivable, 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 loans receivable 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 loans receivable, 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

<i>(In millions)</i>	Three Months Ended August 31				Six Months Ended August 31			
	2020	% <sup>(1)</sup>	2019	% <sup>(1)</sup>	2020	% <sup>(1)</sup>	2019	% <sup>(1)</sup>
Interest margin:								
Interest and fee income	\$ 280.1	8.5	\$ 275.7	8.5	\$ 562.6	8.5	\$ 541.9	8.4
Interest expense	(81.3)	(2.5)	(90.6)	(2.8)	(165.9)	(2.5)	(178.0)	(2.8)
Total interest margin	198.8	6.0	185.1	5.7	396.7	6.0	363.9	5.7
Provision for loan losses	(26.0)	(0.8)	(45.5)	(1.4)	(148.0)	(2.2)	(83.7)	(1.3)
Total interest margin after provision for loan losses	172.8	5.2	139.6	4.3	248.7	3.7	280.2	4.4
Total other expense	(0.3)	—	—	—	(2.2)	—	—	—
Direct expenses:								
Payroll and fringe benefit expense	(11.4)	(0.3)	(10.4)	(0.3)	(22.6)	(0.3)	(20.5)	(0.3)
Other direct expenses	(14.0)	(0.4)	(15.1)	(0.5)	(25.8)	(0.4)	(29.6)	(0.5)
Total direct expenses	(25.4)	(0.8)	(25.5)	(0.8)	(48.4)	(0.7)	(50.1)	(0.8)
CarMax Auto Finance income	\$ 147.2	4.5	\$ 114.1	3.5	\$ 198.1	3.0	\$ 230.1	3.6
Total average managed receivables	\$ 13,218.8		\$ 13,012.1		\$ 13,313.6		\$ 12,859.7	

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

#### 4. Auto Loans Receivable

Auto loans receivable 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 loans receivable 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 loans receivable into the warehouse facilities and asset-backed term funding transactions (together, “non-recourse funding vehicles”) as secured borrowings, which result in recording the auto loans receivable and the related non-recourse notes payable on our consolidated balance sheets. The majority of the auto loans receivable serve as collateral for the related non-recourse notes payable of \$13.38 billion as of August 31, 2020 and \$13.61 billion as of February 29, 2020. See Note 9 for additional information on non-recourse notes payable.

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

#### Auto Loans Receivable, Net

<i>(In millions)</i>	As of August 31 2020	As of February 29 2020
Asset-backed term funding	\$ 10,670.9	\$ 11,007.1
Warehouse facilities	2,253.7	2,181.7
Overcollateralization <sup>(1)</sup>	312.0	289.0
Other managed receivables <sup>(2)</sup>	142.4	140.0
Total ending managed receivables	13,379.0	13,617.8
Accrued interest and fees	61.7	56.2
Other	4.9	35.5
Less: allowance for loan losses	(432.5)	(157.8)
Auto loans receivable, net	\$ 13,013.1	\$ 13,551.7

<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 with the highest probability of repayment are A-grade customers. 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. After origination, credit grades are generally not updated.

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

## Ending Managed Receivables by Major Credit Grade

As of August 31, 2020  
Fiscal Year of Origination <sup>(1)</sup>

<i>(In millions)</i>	2021	2020	2019	2018	2017	Prior to 2017	Total	% <sup>(2)</sup>
A	\$ 1,340.3	\$ 2,649.4	\$ 1,493.6	\$ 814.5	\$ 353.2	\$ 88.6	\$ 6,739.6	50.4
B	938.2	1,729.2	1,093.1	638.5	302.4	112.7	4,814.1	36.0
C and other	322.3	650.9	398.1	239.9	146.1	68.0	1,825.3	13.6
Total ending managed receivables	\$ 2,600.8	\$ 5,029.5	\$ 2,984.8	\$ 1,692.9	\$ 801.7	\$ 269.3	\$ 13,379.0	100.0

<i>(In millions)</i>	As of February 29	
	2020 <sup>(1)</sup>	% <sup>(2)</sup>
A	\$ 6,915.9	50.8
B	4,841.2	35.6
C and other	1,860.7	13.6
Total ending managed receivables	\$ 13,617.8	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.** The allowance for loan losses at August 31, 2020 represents the net credit losses expected over the remaining contractual life of our managed receivables. The allowance for loan losses is determined using a net loss timing curve, primarily based on the composition of the portfolio of managed receivables and historical gross loss and recovery trends. For receivables that have less than 18 months of performance history, the net loss estimate takes into account the credit grades of the receivables and historical losses by credit grade to supplement actual loss data in estimating future performance. Once the receivables have 18 months of performance history, the net loss estimate reflects actual loss experience of those receivables to date, along with forward loss curves, to predict future performance. The forward loss curves are constructed using historical performance data and show the average timing of losses over the course of a receivable's life.

The output of the net loss timing curve is adjusted to take into account reasonable and supportable forecasts about the future. Specifically, the change in U.S. unemployment rates and the NADA used vehicle price index are used to predict changes in gross loss and recovery rate, respectively. An economic adjustment factor is developed to capture the relationship between changes in these forecasts and changes in gross loss and recovery rates. This factor is applied to the output of the net loss timing curve for the reasonable and supportable forecast period of two years. After the end of this two-year period, the impact of the economic factor is phased out of the allowance for loan loss calculation on a straight-line basis over a period of 12 months. We periodically consider whether the use of alternative metrics would result in improved model performance and revise the models when appropriate. The provision for loan losses is the periodic expense of maintaining an adequate allowance.

## Allowance for Loan Losses

<i>(In millions)</i>	Three Months Ended August 31				Six Months Ended August 31			
	2020	% <sup>(1)</sup>	2019 <sup>(2)</sup>	% <sup>(1)</sup>	2020	% <sup>(1)</sup>	2019 <sup>(2)</sup>	% <sup>(1)</sup>
Balance as of beginning of period	\$ 437.2	3.32	\$ 147.0	1.14	\$ 157.8	1.16	\$ 138.2	1.10
Adoption of CECL	—		—		202.0		—	
Adjusted balance as of beginning of period	437.2	3.32	147.0	1.14	359.8	2.64	138.2	1.10
Charge-offs	(53.9)		(76.3)		(124.6)		(142.2)	
Recoveries <sup>(3)</sup>	23.2		34.2		49.3		70.7	
Provision for loan losses	26.0		45.5		148.0		83.7	
Balance as of end of period	\$ 432.5	3.23	\$ 150.4	1.15	\$ 432.5	3.23	\$ 150.4	1.15

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

<sup>(2)</sup> The comparative information has not been restated and continues to be reported under the accounting guidance in effect during fiscal 2020.

<sup>(3)</sup> Net of costs incurred to recover vehicle.

During the first quarter of fiscal 2021, we adopted a new accounting pronouncement related to the measurement of credit losses on financial instruments (ASU 2016-13 or “CECL”). The adoption of this pronouncement resulted in the recognition of a \$202.0 million increase in the allowance for loan losses as of March 1, 2020, with a corresponding net-of-tax decrease of \$153.3 million in retained earnings. During the first six months of fiscal 2021, we recorded a provision for loan losses of \$148.0 million. The first quarter provision of \$122.0 million included an increase in our estimate of lifetime losses on existing loans, largely resulting from worsening economic factors in response to COVID-19. In particular, the U.S. unemployment rate rose significantly during the first quarter. This rate is used in loss prediction to incorporate how current and forecasted economic conditions impact customer hardship, or ability to pay. Changes in the NADA used vehicle price index were not significant. During the second quarter of fiscal 2021, we experienced favorable loss performance in comparison to our loss expectations set at the end of the first quarter, resulting in a \$29.6 million favorable adjustment for receivables then outstanding. This adjustment was more than offset by a \$55.6 million increase to the provision related to our estimate of lifetime losses on originations during the second quarter. While we experienced some loss favorability during the second quarter of fiscal 2021, this favorability was tempered by economic adjustment factors applied to the provision. The allowance for loan losses as of August 31, 2020 reflects the unpredictability of the current environment and the highly uncertain consumer situation.

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

## Past Due Receivables

<i>(In millions)</i>	As of August 31, 2020					
	Major Credit Grade			Total	%	<sup>(1)</sup>
	A	B	C & Other			
Current	\$ 6,713.9	\$ 4,663.4	\$ 1,651.5	\$ 13,028.8		97.38
Delinquent loans:						
31-60 days past due	15.7	94.2	103.9	213.8		1.60
61-90 days past due	7.2	43.5	55.6	106.3		0.79
Greater than 90 days past due	2.8	13.0	14.3	30.1		0.23
Total past due	25.7	150.7	173.8	350.2		2.62
Total ending managed receivables	\$ 6,739.6	\$ 4,814.1	\$ 1,825.3	\$ 13,379.0		100.00

<i>(In millions)</i>	As of February 29	
	2020	% <sup>(1)</sup>
Total ending managed receivables	\$ 13,617.8	100.00
Delinquent loans:		
31-60 days past due	\$ 296.4	2.18
61-90 days past due	138.3	1.01
Greater than 90 days past due	34.2	0.25
Total past due	\$ 468.9	3.44

<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 generally designate these derivative instruments as cash flow hedges for accounting purposes. In certain cases, we may choose not to designate a derivative instrument as a cash flow hedge for accounting purposes due to uncertainty around the probability that future hedged transactions will occur. 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 loans receivable, and (ii) exposure to variable interest rates associated with our term loan.

For the derivatives associated with our non-recourse funding vehicles that are designated as cash flow hedges, the 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 \$22.4 million will be reclassified in AOCL as a decrease to CAF income. Changes in fair value related to derivatives that have not been designated as cash flow hedges for accounting purposes are recognized in the income statement in the period in which the change occurs. For the three and six months ended August 31, 2020, we recognized a loss of \$0.3 million and \$2.2 million, respectively, in CAF income representing these changes in fair value.

As of August 31, 2020 and February 29, 2020, we had interest rate swaps outstanding with a combined notional amount of \$2.52 billion and \$2.62 billion, respectively, that were designated as cash flow hedges of interest rate risk. As of August 31, 2020, we had no interest rate swaps outstanding that were not designated as cash flow hedges.

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 loans receivable 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

<i>(In thousands)</i>	As of August 31, 2020		
	Level 1	Level 2	Total
Assets:			
Money market securities	\$ 852,767	\$ —	\$ 852,767
Mutual fund investments	23,424	—	23,424
Derivative instruments designated as hedges	—	75	75
<b>Total assets at fair value</b>	<b>\$ 876,191</b>	<b>\$ 75</b>	<b>\$ 876,266</b>
Percent of total assets at fair value	100.0 %	— %	100.0 %
Percent of total assets	4.1 %	— %	4.1 %
Liabilities:			
Derivative instruments designated as hedges	\$ —	\$ (9,741)	\$ (9,741)
<b>Total liabilities at fair value</b>	<b>\$ —</b>	<b>\$ (9,741)</b>	<b>\$ (9,741)</b>
Percent of total liabilities	— %	0.1 %	0.1 %

<i>(In thousands)</i>	As of February 29, 2020		
	Level 1	Level 2	Total
Assets:			
Money market securities	\$ 273,203	\$ —	\$ 273,203
Mutual fund investments	22,668	—	22,668
<b>Total assets at fair value</b>	<b>\$ 295,871</b>	<b>\$ —</b>	<b>\$ 295,871</b>
Percent of total assets at fair value	100.0 %	— %	100.0 %
Percent of total assets	1.4 %	— %	1.4 %
Liabilities:			
Derivative instruments designated as hedges	\$ —	\$ (23,992)	\$ (23,992)
<b>Total liabilities at fair value</b>	<b>\$ —</b>	<b>\$ (23,992)</b>	<b>\$ (23,992)</b>
Percent of total liabilities	— %	0.1 %	0.1 %

## 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 loans receivable 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, 2020 and February 29, 2020, respectively, are as follows:

<i>(In thousands)</i>	As of August 31, 2020	As of February 29, 2020
Carrying value	\$ 500,000	\$ 500,000
Fair value	\$ 553,518	\$ 546,197



## 7. Cancellation Reserves

We recognize revenue for EPP products, on a net basis, at the time of sale. We also record a reserve, or refund liability, 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>	Three Months Ended August 31		Six Months Ended August 31	
	2020	2019	2020	2019
Balance as of beginning of period	\$ 116.7	\$ 109.5	\$ 117.9	\$ 102.8
Cancellations	(16.1)	(17.9)	(30.9)	(36.7)
Provision for future cancellations	22.0	20.0	35.6	45.5
Balance as of end of period	\$ 122.6	\$ 111.6	\$ 122.6	\$ 111.6

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, 2020 and February 29, 2020, the current portion of cancellation reserves was \$66.6 million and \$63.5 million, respectively.

## 8. Income Taxes

We had \$29.7 million of gross unrecognized tax benefits as of August 31, 2020, and \$30.9 million as of February 29, 2020. There were no significant changes to the gross unrecognized tax benefits as reported for the year ended February 29, 2020.

## 9. Debt

<i>(In thousands)</i>	Debt Description <sup>(1)</sup>	Maturity Date	As of August 31	As of February 29
			2020	2020
Revolving credit facility <sup>(2) (3)</sup>	June 2024	\$ 575,838	\$ 452,740	
Term loan	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	533,165	536,739	
Non-recourse notes payable	Various dates through May 2027	13,382,375	13,613,272	
Total debt		15,291,378	15,402,751	
Less: current portion		(468,692)	(433,456)	
Less: unamortized debt issuance costs		(24,918)	(25,240)	
Long-term debt, net		\$ 14,797,768	\$ 14,944,055	

<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> On September 16, 2020, we fully paid down the outstanding borrowings under this facility with cash on hand.

**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 of August 31, 2020, the unused capacity of \$874.2 million was fully available to us. On September 16, 2020, we fully paid down the outstanding borrowings under this facility with cash on hand.

**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 loans receivable 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 loans receivable. 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 May 2027, but may mature earlier, depending upon the repayment rate of the underlying auto loans receivable.

Information on our funding vehicles for non-recourse notes payable as of August 31, 2020, are as follows:

<i>(In billions)</i>	<b>Capacity</b>	
Warehouse facilities:		
September 2020 expiration <sup>(1)</sup>	\$	<b>0.15</b>
February 2021 expiration		<b>1.95</b>
August 2021 expiration		<b>1.40</b>
Combined warehouse facility limit	\$	<b>3.50</b>
Unused capacity	\$	<b>1.25</b>
Non-recourse notes payable outstanding:		
Warehouse facilities	\$	<b>2.25</b>
Asset-backed term funding transactions		<b>11.13</b>
Non-recourse notes payable	\$	<b>13.38</b>

<sup>(1)</sup> In September 2020, the expiration date was extended to September 2021 and the capacity was increased to \$175 million.

We generally enter into warehouse facility agreements for one-year terms and typically 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 loans receivable.

**Capitalized Interest.** We capitalize interest in connection with the construction of certain facilities. For the six months ended August 31, 2020 and 2019, we capitalized interest of \$1.4 million and \$3.3 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, 2020, 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, 2020, a total of \$2.0 billion of board authorizations for repurchases of our common stock was outstanding, with no expiration date, of which \$1.51 billion remained available for repurchase. In March 2020, our current stock repurchase program was suspended. The repurchase authorization remained effective and the program resumed in September 2020.

### Common Stock Repurchases

	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2020	2019	2020	2019
Number of shares repurchased <i>(in thousands)</i>	—	1,525.5	515.5	4,478.6
Average cost per share	\$ —	\$ 84.13	\$ 78.96	\$ 74.38
Available for repurchase, as of end of period <i>(in millions)</i>	\$ 1,511.6	\$ 1,780.8	\$ 1,511.6	\$ 1,780.8

### (B) Share-Based Compensation

#### Composition of Share-Based Compensation Expense

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2020	2019	2020	2019
Cost of sales	\$ 2,512	\$ 1,340	\$ 3,191	\$ 4,165
CarMax Auto Finance income	1,542	1,044	2,812	2,849
Selling, general and administrative expenses	34,301	21,903	57,952	62,796
Share-based compensation expense, before income taxes	\$ 38,355	\$ 24,287	\$ 63,955	\$ 69,810

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

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2020	2019	2020	2019
Nonqualified stock options	\$ 6,988	\$ 6,321	\$ 18,607	\$ 18,163
Cash-settled restricted stock units (RSUs)	25,169	13,105	32,574	39,218
Stock-settled market stock units (MSUs)	3,509	3,052	9,355	7,461
Other share-based incentives:				
Stock-settled performance stock units (PSUs)	113	(576)	266	1,633
Restricted stock (RSAs)	33	—	67	—
Stock-settled deferred stock units (DSUs)	1,925	1,960	1,925	2,412
Employee stock purchase plan	618	425	1,161	923
Total other share-based incentives	\$ 2,689	\$ 1,809	\$ 3,419	\$ 4,968
Share-based compensation expense, before income taxes	\$ 38,355	\$ 24,287	\$ 63,955	\$ 69,810

## (C) Stock Incentive Plan Information

### Share/Unit Activity

<i>(Shares/units in thousands)</i>	Six Months Ended August 31, 2020			
	Equity Classified			Liability Classified
	Options	MSUs	Other	RSUs
Outstanding as of February 29, 2020	6,994	477	130	1,557
Granted	1,571	195	22	669
Exercised or vested and converted	(1,438)	(144)	(69)	(505)
Cancelled	(14)	(3)	—	(53)
Outstanding as of August 31, 2020	7,113	525	83	1,668

Weighted average grant date fair value per share/unit:

Granted	\$	22.61	\$	93.11	\$	86.58	\$	71.07
Ending outstanding	\$	19.35	\$	90.24	\$	81.65	\$	70.86

	As of August 31, 2020					
Unrecognized compensation (in millions)	\$	55.4	\$	20.5	\$	1.1

## 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	
	2020	2019	2020	2019
Net earnings	\$ 296,696	\$ 233,599	\$ 301,674	\$ 500,343
Weighted average common shares outstanding	163,434	165,354	163,053	165,839
Dilutive potential common shares:				
Stock options	1,858	1,579	1,193	1,289
Stock-settled stock units and awards	331	339	334	330
Weighted average common shares and dilutive potential common shares	165,623	167,272	164,580	167,458
Basic net earnings per share	\$ 1.82	\$ 1.41	\$ 1.85	\$ 3.02
Diluted net earnings per share	\$ 1.79	\$ 1.40	\$ 1.83	\$ 2.99

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, 2020 and 2019, options to purchase 29,200 shares and 1,288,413 shares of common stock, respectively, were not included. For the six months ended August 31, 2020 and 2019, options to purchase 2,061,194 shares and 1,096,811 shares of common stock, respectively, were not included.



## 12. Accumulated Other Comprehensive Loss

### Changes in Accumulated Other Comprehensive Loss By Component

	Net Unrecognized Actuarial Losses	Net Unrecognized Hedge Losses	Total Accumulated Other Comprehensive Loss
<i>(In thousands, net of income taxes)</i>			
Balance as of February 29, 2020	\$ (121,302)	\$ (28,769)	\$ (150,071)
Other comprehensive loss before reclassifications	—	(18,229)	(18,229)
Amounts reclassified from accumulated other comprehensive loss	1,456	6,418	7,874
Other comprehensive income (loss)	1,456	(11,811)	(10,355)
Balance as of August 31, 2020	\$ (119,846)	\$ (40,580)	\$ (160,426)

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

	Three Months Ended August 31		Six Months Ended August 31	
	2020	2019	2020	2019
<i>(In thousands)</i>				
<b>Retirement Benefit Plans:</b>				
Actuarial loss amortization reclassifications recognized in net pension expense:				
Cost of sales	\$ 437	\$ 201	\$ 810	\$ 398
CarMax Auto Finance income	25	12	56	24
Selling, general and administrative expenses	498	256	1,053	515
Total amortization reclassifications recognized in net pension expense	960	469	1,919	937
Tax expense	(232)	(113)	(463)	(226)
Amortization reclassifications recognized in net pension expense, net of tax	728	356	1,456	711
Net change in retirement benefit plan unrecognized actuarial losses, net of tax	728	356	1,456	711
<b>Cash Flow Hedges (Note 5):</b>				
Changes in fair value	79	(15,431)	(24,783)	(33,373)
Tax (expense) benefit	(21)	4,077	6,554	8,819
Changes in fair value, net of tax	58	(11,354)	(18,229)	(24,554)
Reclassifications to CarMax Auto Finance income	5,701	780	8,726	303
Tax expense	(1,508)	(206)	(2,308)	(80)
Reclassification of hedge losses, net of tax	4,193	574	6,418	223
Net change in cash flow hedge unrecognized losses, net of tax	4,251	(10,780)	(11,811)	(24,331)
Total other comprehensive income (loss), net of tax	\$ 4,979	\$ (10,424)	\$ (10,355)	\$ (23,620)

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 \$52.6 million as of August 31, 2020 and \$48.8 million as of February 29, 2020.



### 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>	Three Months Ended August 31		Six Months Ended August 31	
	2020	2019	2020	2019
Operating lease cost <sup>(1)</sup>	\$ 14,351	\$ 14,257	\$ 28,735	\$ 28,812
Finance lease cost:				
Depreciation of lease assets	1,719	1,453	3,374	2,551
Interest on lease liabilities	2,433	1,969	4,648	3,446
Total finance lease cost	4,152	3,422	8,022	5,997
Total lease cost	\$ 18,503	\$ 17,679	\$ 36,757	\$ 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 2020</b>	<b>As of February 29 2020</b>
<b>Assets:</b>			
Operating lease assets	Operating lease assets	\$ 444,158	\$ 449,094
Finance lease assets	Property and equipment, net <sup>(1)</sup>	84,545	75,320
Total lease assets		\$ 528,703	\$ 524,414
<b>Liabilities:</b>			
Current:			
Operating leases	Current portion of operating lease liabilities	\$ 31,616	\$ 30,980
Finance leases	Accrued expenses and other current liabilities	5,997	5,066
Long-term:			
Operating leases	Operating lease liabilities, excluding current portion	435,113	440,671
Finance leases	Other liabilities	92,201	79,327
Total lease liabilities		\$ 564,927	\$ 556,044

<sup>(1)</sup> Finance lease assets are recorded net of accumulated depreciation of \$12.5 million as of August 31, 2020 and \$9.1 million as of February 29, 2020.

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

<b>Lease Term and Discount Rate</b>	<b>As of August 31 2020</b>	<b>As of February 29 2020</b>
Weighted Average Remaining Lease Term (in years)		
Operating leases	19.60	19.98
Finance leases	13.62	13.55
Weighted Average Discount Rate		
Operating leases	5.37 %	5.40 %
Finance leases	10.66 %	10.32 %

Supplemental cash flow information related to leases was as follows:

<i>(In thousands)</i>	<b>Six Months Ended August 31</b>	
	<b>2020</b>	<b>2019</b>
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 28,524	\$ 28,601
Operating cash flows from finance leases	\$ 3,872	\$ 1,581
Financing cash flows from finance leases	\$ 2,880	\$ 1,694
Lease assets obtained in exchange for lease obligations:		
Operating leases	\$ 10,740	\$ 19,137
Finance leases	\$ 15,711	\$ 43,653

Maturities of lease liabilities were as follows:

<i>(In thousands)</i>	<b>As of August 31, 2020</b>	
	<b>Operating Leases<sup>(1)</sup></b>	<b>Finance Leases<sup>(1)</sup></b>
Fiscal 2021, remaining	\$ 27,680	\$ 7,627
Fiscal 2022	52,780	16,151
Fiscal 2023	50,211	16,401
Fiscal 2024	49,339	19,123
Fiscal 2025	48,214	15,415
Thereafter	573,369	115,685
Total lease payments	801,593	190,402
Less: interest	(334,864)	(92,204)
Present value of lease liabilities	\$ 466,729	\$ 98,198

<sup>(1)</sup> Lease payments exclude \$112.1 million of legally binding minimum lease payments for leases signed but not yet commenced.

#### **14. Supplemental Cash Flow Information**

Supplemental disclosures of cash flow information:

<i>(In thousands)</i>	<b>Six Months Ended August 31</b>	
	<b>2020</b>	<b>2019</b>
Non-cash investing and financing activities:		
(Decrease) increase in accrued capital expenditures	\$ (30,821)	\$ 2,226
Increase in financing obligations	\$ —	\$ 31,893

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.

CarMax has reached a global agreement settling the Weiss, Gomez and McElhannon lawsuits on a class basis. The settlement agreement was submitted for pre-approval to the Superior Court of California, County of Placer on August 14, 2020 as part of the Weiss lawsuit and the settlement is expected to be submitted for final approval following the completion of required class procedures. In anticipation of the consolidation of claims under the global settlement agreement, on March 11, 2020, the Gomez and McElhannon lawsuits were dismissed, as the claims of the plaintiffs will be addressed in the global settlement. The monetary settlement under this agreement is for an immaterial amount that has been fully accrued.



The Sabanovich lawsuit is not included in the global settlement agreement. 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.

As previously reported, the company has cooperated with representatives from multiple California municipality district attorney offices in an inquiry by those offices into the handling, storage and disposal of certain types of hazardous waste at our store locations in those municipalities. CarMax and the district attorney offices have reached a settlement agreement, which was entered and approved by the Superior Court of California, County of Orange on June 8, 2020. The settlement includes an immaterial monetary payment covering penalties, costs, and supplemental environmental projects as well as certain injunctive relief.

The company is a class member in a consolidated and settled class action lawsuit (In re: Takata Airbag Product Liability Litigation (U.S. District Court, Southern District of Florida)) against Toyota, Mazda, Subaru, BMW, Honda, Nissan and Ford related to the economic loss associated with defective Takata airbags installed as original equipment in certain model vehicles from model years 2000-2018. On April 15, 2020, CarMax received \$40.3 million in net recoveries from the Toyota, Mazda, Subaru, BMW, Honda and Nissan settlement funds. CarMax remains a class member for the Ford settlement fund. We are unable to make a reasonable estimate of the amount or range of gain that could result from CarMax's participation in the Ford settlement fund.

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 \$15.7 million as of August 31, 2020, and \$10.5 million as of February 29, 2020, 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 29, 2020 ("fiscal 2020"), 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 and most profitable 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 omni-channel experience, which gives us the largest addressable market in the used car industry, empowers customers to buy a car on their terms – online, in-store or a seamless integration of both. Customers can choose to complete the car-buying experience in-person at one of our stores; or buy the car online and receive delivery through contactless curbside pickup, available nationwide, or home delivery, available to most customers.

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, 2020, we operated 220 used car stores in 106 U.S. television markets, as well as 2 new car franchises. As of that date, wholesale auctions previously held at 74 of our used car stores were being conducted virtually.

#### **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 loans receivable 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 40.1% of our retail used vehicle unit sales in the first six months of fiscal 2021. As of August 31, 2020, CAF serviced approximately 1,027,000 customer accounts in its \$13.38 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 loans receivable, including trends in credit losses and delinquencies, and CAF direct expenses.

#### **Impact of COVID-19**

In March 2020, the World Health Organization declared the outbreak of the novel coronavirus ("COVID-19") as a global pandemic. In the following weeks, many U.S. states and localities issued shelter-in-place orders impacting the operations of our stores and consumer demand. We followed mandates from public health officials and government agencies, including implementation of enhanced cleaning measures and social distancing guidelines and, in many localities, the closing of stores and wholesale auctions. As a result of these store closures and lower consumer demand, we announced in April 2020 that more than 15,000 associates had been placed on furlough. During the first six months of fiscal 2021, we spent approximately



\$30 million supporting associates impacted by COVID-19, store closures and furloughs. This included providing associates with at least 14 days of pay continuity upon store closure or quarantine, along with continuing medical benefits for associates who were furloughed. During the second quarter of fiscal 2021, we began to call back associates from furlough and by the end of July 2020, we no longer had any associates on furlough.

We have implemented robust plans to reduce the risk of exposure and further spread of the virus in our stores and continue to follow the mandates of public health officials and government agencies. We also launched contactless curbside pickup nationwide to better serve our customers in alignment with enhanced safety practices. In addition, we quickly shifted our wholesale business from in-person to online auctions, and we continue to keep our appraisal lanes open for customers who want or need to sell their cars. During the second quarter of fiscal 2021, we completed the rollout of our omni-channel experience, which gives us the largest addressable market in the used car industry. This offering gives customers the option to seamlessly do as much, or as little, online and in-person as they prefer.

At the peak of the COVID-19 pandemic in early April, due to the mandates of public health officials and government agencies, approximately half of our stores were closed or under limited operations. Limited operations means the stores could sell cars but were limited to appointment-only, curbside pickup, home delivery or some combination of all three. As a result, used vehicle sales were down more than 75% during that period. Further, pricing and margin was pressured by sharp declines in industry wholesale valuations due to a steep depreciation environment. During this period, we reduced inventory levels to align with sales.

Since hitting a trough in early April, we have seen our sales improve as stores reopened, occupancy restrictions eased and customers re-engaged in car buying. As of August 31, 2020, all of our stores were open, but many continue to run under occupancy restrictions. We experienced negative comparable used unit sales in the first quarter of fiscal 2021, which continued into June when we experienced high single digit negative comparable used unit sales. The June results were more than offset by mid single digit positive comparable used unit sales in both July and August, a trend that continued through September. As demand increased during the second quarter, we were able to build our saleable inventory by more than 50% and successfully ramped up to target levels in September.

The impact of COVID-19 on CAF loan origination volume has been consistent with our retail and wholesale sales performance noted above. As the pandemic escalated, we saw an increase in delinquencies and greater demand for payment extensions. In response, we implemented a variety of measures to support our customers through this difficult time and to maximize the long-term collectability of the portfolio. This included temporarily suspending repossessions, waiving late fees, and providing loan payment extensions where appropriate. In addition to pausing our in-house Tier 3 lending, we also made temporary underwriting adjustments focused on preserving CAF's high-quality portfolio and tested certain loan routing to our third-party providers.

Payment extensions spiked in April and have declined significantly since then as customers have exhibited the ability and willingness to pay. During the first six months of fiscal 2021, delinquency rates were lower year-over-year. During the back half of the second quarter of fiscal 2021, we ceased CAF's underwriting adjustments noted above, and in September we resumed our in-house Tier 3 lending.

In response to COVID-19, we took several measures in the first quarter of fiscal 2021 to enhance our liquidity position and provide additional financial flexibility. This included drawing down additional funds on our revolving credit facility, pausing our stock repurchase program, pausing our store expansion strategy and remodels, reducing inventory levels and aligning other operating expenses to the lower sales volume. In addition to the temporary furlough mentioned above, we also implemented a hiring freeze, reduced advertising spending and reduced labor hours. As of the end of the second quarter, we are actively hiring nationwide and have resumed our store expansion strategy with plans to open between eight and ten stores in fiscal 2022. Subsequent to the end of the second quarter, we used our cash on hand to fully pay down the outstanding balance on our revolving credit facility and resumed our share repurchase program.

During the first quarter of fiscal 2021, new legislation was enacted, and new IRS guidance was issued to provide relief to businesses in response to the COVID-19 pandemic. We have evaluated the tax provisions included in legislation such as the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), as well as recent IRS guidance. While the most significant impacts to the company include the employee retention tax credit and payroll tax deferral provisions of the CARES Act, we do not expect recent IRS guidance or the CARES Act to have a material impact on our results of operations.

The COVID-19 pandemic remains a rapidly evolving situation. We continue to actively monitor developments that may cause us to take further actions that alter our business operations as may be required by federal, state or local authorities or that we determine are in the best interests of our associates, customers and shareholders. The duration and severity of the COVID-19



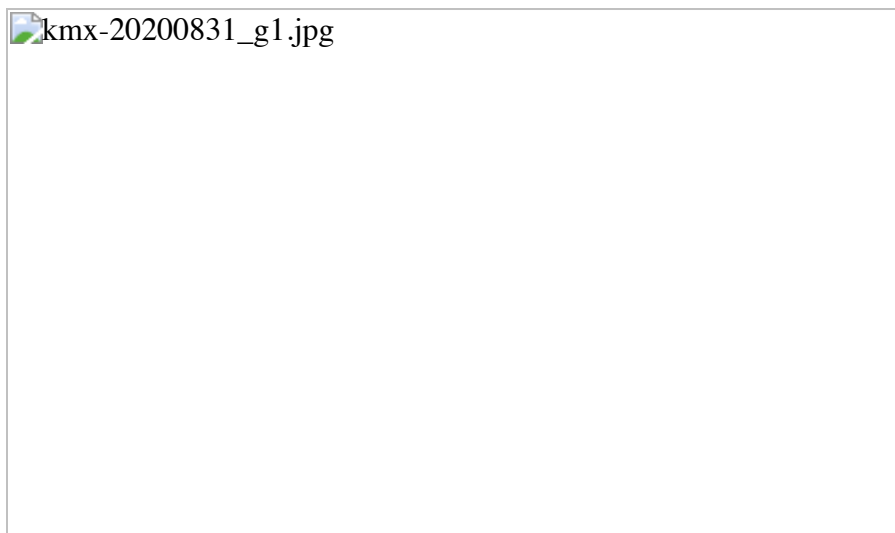
outbreak are uncertain, and we are unable to determine the full impact that social distancing protocols, or potential subsequent outbreaks, will ultimately have on our operations or consumer demand. As such, the full impact on our revenues, profitability, financial position and liquidity remains uncertain at this time.


### **Revenues and Profitability**

The sources of revenue and gross profit from the CarMax Sales Operations segment for the first six months of fiscal 2021 are as follows:

#### **Net Sales and Operating Revenues**

#### **Gross Profit**

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A high-level summary of our financial results for the second quarter and first half of fiscal 2021 as compared to the second quarter and first half of fiscal 2020 is as follows:

	<b>Three Months Ended August 31, 2020</b>	<b>Change from Three Months Ended August 31, 2019</b>	<b>Six Months Ended August 31, 2020</b>	<b>Change from Six Months Ended August 31, 2019</b>
<i>(Dollars in millions except per share or per unit data)</i>				
<b>Income statement information</b>				
Net sales and operating revenues	\$ 5,372.2	3.3 %	\$ 8,600.9	(18.6)%
Gross profit	\$ 752.1	8.5 %	\$ 1,106.3	(22.9)%
CAF income	\$ 147.2	29.0 %	\$ 198.1	(13.9)%
Selling, general and administrative expenses	\$ 490.2	2.0 %	\$ 863.9	(11.0)%
Net earnings	\$ 296.7	27.0 %	\$ 301.7	(39.7)%
<b>Unit sales information</b>				
Used unit sales	217,330	3.9 %	352,358	(18.7)%
Change in used unit sales in comparable stores	1.2 %	N/A	(21.0)%	N/A
Wholesale unit sales	132,980	5.1 %	196,275	(20.6)%
<b>Per unit information</b>				
Used gross profit per unit	\$ 2,214	1.4 %	\$ 2,108	(4.2)%
Wholesale gross profit per unit	\$ 1,086	17.0 %	\$ 1,051	6.8 %
SG&A per used vehicle unit	\$ 2,256	(1.9)%	\$ 2,452	9.5 %
<b>Per share information</b>				
Net earnings per diluted share	\$ 1.79	27.9 %	\$ 1.83	(38.8)%

Net earnings per diluted share during the first half of fiscal 2021 included a one-time benefit of \$0.18 in connection with our receipt of settlement proceeds in April 2020 related to a previously disclosed class action lawsuit. 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. In addition to funding our operations, this liquidity was historically used to fund the repurchase of common stock under our share repurchase program and our store growth. Our current capital allocation strategy is to remain focused on growing the business while maintaining the appropriate amount of caution given the uncertainty that remains in the economic environment.

As noted above, in response to the COVID-19 situation, we took certain measures in the first quarter of fiscal 2021 to enhance our liquidity position and provide additional financial flexibility, including drawing down additional funds on our revolving credit facility, pausing our stock repurchase program, pausing our store expansion strategy and remodels and actively aligning operating expenses to the current state of the business, including the previously discussed furlough. We strengthened our overall financial position by selling through inventory and quickly aligning costs to lower sales volumes. As demand increased during the second quarter, we were able to build our saleable inventory by more than 50% and successfully ramped up to target levels in September. Subsequent to the end of the second quarter, we fully paid down the outstanding balance on our revolving credit facility and resumed our store expansion strategy and share repurchase program. Given the turnaround in our business, the strength of the credit markets and our solid balance sheet, we believe we have the appropriate liquidity, access to capital and financial strength to support our operations and continue investing in our omni and digital initiatives for the foreseeable future.

### **Future Outlook**

The COVID-19 situation has created an unprecedented and challenging time. As discussed above, we have taken several steps to ensure a strong liquidity position and enable our stores to operate amidst the current health and safety concerns. We will continue to monitor the COVID-19 situation and make any further decisions necessary to position the company for a strong recovery as we emerge from this crisis.

We recognize the current environment has accelerated a shift in consumer buying behavior. Customers are seeking safety, personalization and convenience more than ever in how they shop for and buy a vehicle. 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. The current environment creates an opportunity for us to use our unique consumer offering to capitalize on our current position and grow market share. We completed our omni-channel rollout in the second quarter of fiscal 2021 and are now focusing our efforts on optimizing this customer experience with new enhancements.

In the near term, our strategic investments will focus on our customer experience, vehicle acquisition and marketing. As we go forward, we plan to focus on clearly differentiating our brand from digital-only and traditional dealer brands by demonstrating the benefits of our omni-channel offering. As a result, we plan to increase our year-over-year marketing spend in the second half of fiscal 2021. We also continue to focus on driving effectiveness through our centralized CECs, improving our core buying channels and opening new buying channels and modernizing our wholesale auction platforms. While it is still a relatively new capability for us and still maturing, our CECs are quickly becoming more effective than our previous model. Approximately 70% of our customers interacted with our CECs during the second quarter. Additionally, approximately 50% of our customers chose to progress their sale remotely, which is up from 42% prior to COVID-19. We have taken decisive actions since the start of the COVID-19 pandemic that have supported our ability to appropriately manage costs. We will continue to act on opportunities to become leaner, more agile and a more cost-effective organization over the long term.

Our long-term strategy continues to be focused on completing the rollout of our retail concept and optimizing our omni-channel experience, with the goal of increasing our share of used vehicle unit sales in each of the markets in which we operate. At the same time, we are identifying and investing in new initiatives that we believe will also be solid contributors to our earnings growth. We believe, over the long term, used vehicle unit sales are the primary driver for earnings growth. We also believe increased used vehicle unit sales will drive increased sales of wholesale vehicles and ancillary products and, over time, increased CAF income.

In calendar 2019, we estimate we sold approximately 4.7% of the age 0- to 10-year old vehicles sold in the comparable store markets in which we were operating and approximately 3.5% of the age 0- to 10-year old vehicles sold on a nationwide basis. Our strategy to increase our market share includes focusing on:

- Delivering a customer-driven, omni-channel buying and selling experience that is a unique and powerful integration of our in-store and online capabilities.
- Opening stores in new markets and expanding our presence in existing markets.
- 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 have invested 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 enhance customer experiences, such as finance pre-approval, online appraisal, home delivery and curbside pick-up. We are also developing and implementing tools that help our associates be more efficient and effective. Additionally, we have centralized customer support in our CECs, which we believe provides 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. While in any individual period conditions may vary, in periods of elevated investment in our strategic initiatives, we would expect to leverage our SG&A expenses when comparable store used unit sales growth is in the range of 5% to 8% on an annual basis.

As of August 31, 2020, we had used car stores located in 106 U.S. television markets, which covered approximately 78% of the U.S. population. The format and operating models utilized in our stores are continuously evaluated and may change or evolve over time based upon market and consumer expectations. During the first six months of fiscal 2021, we opened four stores. In response to COVID-19, we paused our store expansion strategy in the first quarter of fiscal 2021. We are resuming new store growth and anticipate opening between eight and ten stores in fiscal 2022.

While we execute both our short- and 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 29, 2020.

## **CRITICAL ACCOUNTING POLICIES**

For information on critical accounting policies, see "Critical Accounting Policies" in the MD&A included in Item 7 of the Annual Report on Form 10-K for the fiscal year ended February 29, 2020 and Part I, Item 2 of the Quarterly Report on Form 10-Q for the period ended May 31, 2020.

## 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		
	2020	2019	Change	2020	2019	Change
Used vehicle sales	\$ 4,389.2	\$ 4,346.3	1.0 %	\$ 7,175.4	\$ 8,887.0	(19.3)%
Wholesale vehicle sales	819.1	678.3	20.8 %	1,161.9	1,340.7	(13.3)%
Other sales and revenues:						
Extended protection plan revenues	119.4	113.3	5.4 %	192.8	224.6	(14.2)%
Third-party finance fees, net	(15.4)	(10.3)	(49.6)%	(26.2)	(25.8)	(1.4)%
Other	59.9	73.6	(18.6)%	97.0	141.0	(31.2)%
Total other sales and revenues	163.9	176.6	(7.2)%	263.6	339.8	(22.4)%
Total net sales and operating revenues	\$ 5,372.2	\$ 5,201.2	3.3 %	\$ 8,600.9	\$ 10,567.5	(18.6)%

### UNIT SALES

	Three Months Ended August 31			Six Months Ended August 31		
	2020	2019	Change	2020	2019	Change
Used vehicles	217,330	209,091	3.9 %	352,358	433,359	(18.7)%
Wholesale vehicles	132,980	126,513	5.1 %	196,275	247,281	(20.6)%

### AVERAGE SELLING PRICES

	Three Months Ended August 31			Six Months Ended August 31		
	2020	2019	Change	2020	2019	Change
Used vehicles	\$ 19,991	\$ 20,581	(2.9)%	\$ 20,127	\$ 20,306	(0.9)%
Wholesale vehicles	\$ 5,891	\$ 5,090	15.7 %	\$ 5,639	\$ 5,150	9.5 %

### COMPARABLE STORE USED VEHICLE SALES CHANGES

	Three Months Ended August 31 <sup>(1)</sup>		Six Months Ended August 31 <sup>(1)</sup>	
	2020	2019	2020	2019
Used vehicle units	1.2 %	3.2 %	(21.0)%	6.3 %
Used vehicle revenues	(1.6)%	6.3 %	(21.6)%	7.9 %

<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	
	2020	2019	2020	2019
Used vehicle units	3.9 %	6.2 %	(18.7)%	9.6 %
Used vehicle revenues	1.0 %	9.3 %	(19.3)%	11.1 %
Wholesale vehicle units	5.1 %	4.7 %	(20.6)%	5.6 %
Wholesale vehicle revenues	20.8 %	8.0 %	(13.3)%	7.6 %



## 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>	
	2020	2019	2020	2019
CAF <sup>(2)</sup>	45.7 %	46.8 %	42.8 %	46.5 %
Tier 2 <sup>(3)</sup>	22.3 %	19.7 %	24.7 %	20.0 %
Tier 3 <sup>(4)</sup>	11.1 %	9.6 %	12.4 %	10.6 %
Other <sup>(5)</sup>	20.9 %	23.9 %	20.1 %	22.9 %
<b>Total</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>100.0 %</b>

<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	
	2020	2019	2020	2019
Used car stores, beginning of period	220	206	216	203
Store openings	—	3	4	6
Used car stores, end of period	220	209	220	209

During the first six months of fiscal 2021, we opened four stores, all in existing television markets (Tampa, FL; Philadelphia, PA; New Orleans, LA; and Los Angeles, CA).

**Used Vehicle Sales.** The 1.0% increase in used vehicle revenues in the second quarter of fiscal 2021 was primarily due to a 3.9% increase in used unit sales. The increase in used units included a 1.2% 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 reflected strong conversion, continued support from financing, growth in web initiated selling opportunities, and solid execution by our associates in our stores and our customer experience centers. A strengthening used car environment also benefited the quarter, and though inventory availability was a headwind to sales, we returned to targeted inventory levels in September.

The 19.3% decrease in used vehicle revenues in the first six months of fiscal 2021 was primarily due to an 18.7% decrease in used unit sales. The decrease in used units included a 21.0% decrease in comparable store used unit sales. This reflected the combined effects of COVID-19 related store closures and restrictions on operations, as well as reduced customer traffic resulting from the economic impact of the pandemic and nationwide shelter-in-place orders, primarily during the first quarter of fiscal 2021. We experienced negative comparable used unit sales in the first quarter of fiscal 2021, which continued through June. This was partially offset by positive comparable used unit sales in both July and August.

The decrease in average retail selling price in the second quarter of fiscal 2021 reflected shifts in the mix of our sales by both vehicle age and class. The decrease in average retail selling price in the first six months of fiscal 2021 reflected shifts in the mix of our sales by both vehicle age and class, partially offset by higher vehicle acquisition costs.

**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 20.8% increase in wholesale vehicle revenues in the second quarter of fiscal 2021 was primarily due to a 5.1% increase in unit sales as well as a 15.7% increase in average selling price. The wholesale unit growth was largely driven by a record appraisal buy rate, partially offset by lower appraisal traffic. Additionally, wholesale unit sales benefited from an extra auction day in the quarter.



The 13.3% decrease in wholesale vehicle revenues in the first six months of fiscal 2021 was primarily due to a 20.6% decline in unit sales, partially offset by a 9.5% increase in average selling price. The wholesale unit decrease was largely driven by lower appraisal traffic, partially offset by an increase in our appraisal buy rate.

The increase in average selling price in both the second quarter and first six months of fiscal 2021 was primarily due to increased acquisition costs driven by market appreciation.

**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 declined 7.2% in the second quarter of fiscal 2021, reflecting a decrease in other revenues, including new car and service department sales, and an increase in net third-party finance fees, partially offset by growth in EPP revenues. EPP revenues increased 5.4%, largely reflecting the growth in our used unit sales as well as a year-over-year increase of \$1.7 million related to profit-sharing revenue.

Other sales and revenues declined 22.4% in the first six months of fiscal 2021, reflecting decreases in other revenues, including new car and service department sales, and EPP revenues. EPP revenues declined 14.2%, largely reflecting the reduction in our used unit sales, partially offset by a year-over-year increase of \$5.1 million related to profit-sharing revenue. The new car and service department sales declines reflected both store closures and reduced customer traffic.

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

## GROSS PROFIT

<i>(In millions)</i>	Three Months Ended August 31			Six Months Ended August 31		
	2020	2019	Change	2020	2019	Change
Used vehicle gross profit	\$ 481.2	\$ 456.4	5.4 %	\$ 742.7	\$ 953.2	(22.1)%
Wholesale vehicle gross profit	144.4	117.4	23.0 %	206.3	243.3	(15.2)%
Other gross profit	126.5	119.7	5.8 %	157.3	239.3	(34.2)%
Total	\$ 752.1	\$ 693.5	8.5 %	\$ 1,106.3	\$ 1,435.8	(22.9)%

## GROSS PROFIT PER UNIT

	Three Months Ended August 31				Six Months Ended August 31			
	2020		2019		2020		2019	
	\$ 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	\$ 2,214	11.0	\$ 2,183	10.5	\$ 2,108	10.4	\$ 2,200	10.7
Wholesale vehicle gross profit	\$ 1,086	17.6	\$ 928	17.3	\$ 1,051	17.8	\$ 984	18.1
Other gross profit	\$ 583	77.3	\$ 572	67.8	\$ 447	59.7	\$ 552	70.4
Total gross profit	\$ 3,461	14.0	\$ 3,317	13.3	\$ 3,140	12.9	\$ 3,313	13.6

<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 increased 5.4% in the second quarter of fiscal 2021, reflecting the 3.9% increase in total used unit sales and strong execution, which contributed to the \$31 increase in used vehicle gross profit per unit. Used vehicle gross profit declined 22.1% in the first six months of fiscal 2021, reflecting the 18.7% decline in total used unit sales as well as the \$92 decline in used vehicle gross profit per unit. During the first quarter of fiscal 2021, our used vehicle gross profit per unit was pressured by pricing adjustments made to better align inventory levels with sales in response to COVID-19. We believe we can manage to a targeted gross profit per unit dollar range, subject to future changes to our business or pricing strategy. With regard to the COVID-19 pandemic, we believe significant pressures on gross profit per unit are behind us; however, gross profit per unit performance is largely dependent on sales trends and ongoing economic recovery.

**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 23.0% in the second quarter of fiscal 2021, reflecting the 5.1% increase in wholesale unit sales, robust appreciation in the market and strong execution, which contributed to the \$158 increase in wholesale gross profit per unit. Wholesale vehicle gross profit decreased 15.2% in the first six months of fiscal 2021, driven by the 20.6% decrease in wholesale unit sales, partially offset by a \$67 increase in wholesale gross profit per unit. Wholesale gross profit per unit was under significant pressure early in the current year's first quarter, reflecting sharp declines in industry wholesale valuations; however, wholesale gross profit per unit had fully recovered by the end of the first quarter. During the second quarter of fiscal 2021, performance was supported by strong appreciation in the market. By the end of the quarter, depreciation had returned to the wholesale market.

**Other Gross Profit.** Other gross profit includes profits related to EPP revenues, net third-party finance fees and other revenues. Other revenues 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.

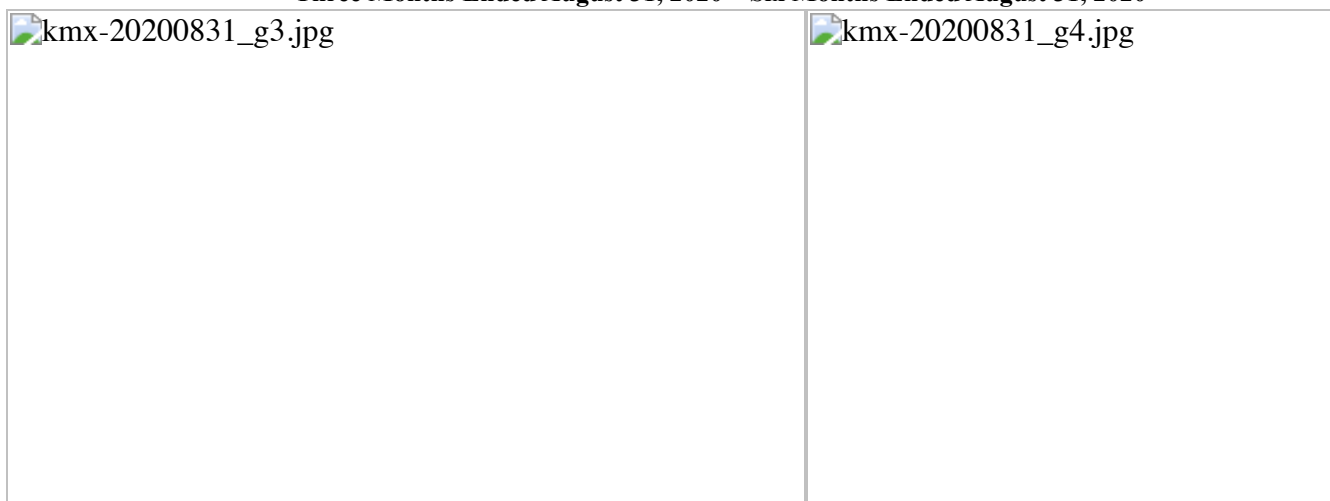
Other gross profit increased 5.8% in the second quarter of fiscal 2021, reflecting the increase in EPP revenues, partially offset by the increase in net third-party finance fees. The increase was also due to an increase in service department profits, reflecting improved overhead leverage resulting from our growth in used unit sales as well as the employee retention tax credit enacted as part of the CARES Act. Other gross profit decreased 34.2% in the first six months of fiscal 2021, reflecting a decline in service department profits and EPP revenues. Service results in the first six months of fiscal 2021 reflected the overhead deleverage resulting from our decline in used car sales, as well as pay continuity for our technicians and other service personnel during periods of reduced vehicle reconditioning activity in the first quarter. Service results for the six-month period also continued to be adversely affected by the increase in our post-sale warranty period from 30 to 90 days implemented in May 2019.

**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 can 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

Three Months Ended August 31, 2020    Six Months Ended August 31, 2020



### 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		
	2020	2019	Change	2020	2019	Change
Compensation and benefits:						
Compensation and benefits, excluding share-based compensation expense	\$ 239.3	\$ 227.5	5.2 %	\$ 430.5	\$ 457.4	(5.9)%
Share-based compensation expense	34.3	21.9	56.6 %	58.0	62.8	(7.7)%
Total compensation and benefits <sup>(1)</sup>	\$ 273.6	\$ 249.4	9.7 %	\$ 488.5	\$ 520.2	(6.1)%
Store occupancy costs	101.1	96.7	4.5 %	195.7	193.3	1.2 %
Advertising expense	50.5	46.8	7.7 %	85.0	88.8	(4.3)%
Other overhead costs <sup>(2)</sup>	65.0	87.9	(26.0)%	94.7	168.2	(43.7)%
Total SG&A expenses	\$ 490.2	\$ 480.8	2.0 %	\$ 863.9	\$ 970.5	(11.0)%
SG&A per used vehicle unit <sup>(3)</sup>	\$ 2,256	\$ 2,300	\$ (44)	\$ 2,452	\$ 2,239	\$ 213

<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, preopening and relocation costs, insurance, 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 2.0% in the second quarter of fiscal 2021. This increase reflected increased costs as a result of the 7% growth in our store base since the beginning of last year's second quarter (representing the addition of 14 stores) and continued spend in omnichannel and core strategic initiatives, partially offset by actions taken during the early stages of the COVID-19 pandemic to reduce costs, including aligning staffing and other overhead costs to the business and pausing our store expansion. The increase also included the following:

- \$12.4 million increase in share-based compensation expense. The increase in share-based compensation expense was primarily related to cash-settled restricted stock units, as the expense associated with these units was driven by the change in the company's stock price during the relevant periods.
- \$3.7 million increase in advertising expense. We plan to increase our year-over-year advertising expense during the remainder of the current year.
- \$22.9 million decrease in other overhead costs, driven by the factors listed above as well as reduced self-insurance loss and litigation-related expenses.



SG&A expenses decreased 11.0% in the first six months of fiscal 2021. This decrease reflected a reduction in costs associated with our decline in sales volume and actions taken in response to the COVID-19 pandemic to reduce costs, as noted above, partially offset by an increase in costs as a result of the 8% growth in our store base since the beginning of fiscal 2020 (representing the addition of 17 stores) and continued spend in omni-channel and core strategic initiatives. The decrease also included the following:

- \$40.3 million one-time benefit, representing our receipt of settlement proceeds in a class action lawsuit related to the economic loss associated with vehicles containing Takata airbags.
- \$4.8 million decrease in share-based compensation expense. The decrease in share-based compensation expense was primarily related to cash-settled restricted stock units, as the expense associated with these units was driven by the change in the company's stock price during the relevant periods.
- \$3.8 million decrease in advertising expense. We plan to increase our year-over-year advertising expense during the remainder of the current year.

**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 remained relatively flat at \$22.5 million in the second quarter of fiscal 2021 compared with \$21.1 million in the second quarter of fiscal 2020. Interest expense increased to \$46.4 million in the first six months of fiscal 2021 from \$38.9 million in the first six months of fiscal 2020. The increase primarily reflected increased expense for our financing obligations as well as a higher outstanding average revolver balance in the current year period, partially offset by lower interest rates.

**Income Taxes.** The effective income tax rate was 23.6% in the second quarter of fiscal 2021 and 23.1% in the first six months of fiscal 2021 versus 23.5% in the second quarter of fiscal 2020 and 23.8% in the first six months of fiscal 2020.

## **RESULTS OF OPERATIONS – CARMAX AUTO FINANCE**

CAF income primarily reflects interest and fee income generated by CAF's portfolio of auto loans receivable 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. Increases in interest rates, which affect CAF's funding costs, or other competitive pressures on consumer rates, could result in 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 changes in loss and delinquency experience and economic factors on our outlook for net losses expected to occur over the remaining contractual life of the loans receivable.

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. Historically, we have strived 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 (including the effects of the COVID-19 outbreak) and wholesale recovery rates. Based on underwriting adjustments made during the first quarter of fiscal 2021, in response to higher anticipated losses related to COVID-19, we targeted new loans toward the higher end of this range. In the second quarter of fiscal 2021, we ceased the underwriting adjustments made during the previous quarter and loans originated continued to be targeted at the higher end, or slightly above, this range. 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. Loans originated in a given fiscal period impact CAF income over time, as we recognize income over the life of the underlying auto loan.

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 loans receivable, including credit quality.

## SELECTED CAF FINANCIAL INFORMATION

<i>(In millions)</i>	Three Months Ended August 31				Six Months Ended August 31			
	2020	% <sup>(1)</sup>	2019	% <sup>(1)</sup>	2020	% <sup>(1)</sup>	2019	% <sup>(1)</sup>
Interest margin:								
Interest and fee income	\$ 280.1	8.5	\$ 275.7	8.5	\$ 562.6	8.5	\$ 541.9	8.4
Interest expense	(81.3)	(2.5)	(90.6)	(2.8)	(165.9)	(2.5)	(178.0)	(2.8)
Total interest margin	\$ 198.8	6.0	\$ 185.1	5.7	\$ 396.7	6.0	\$ 363.9	5.7
Provision for loan losses	\$ (26.0)	(0.8)	\$ (45.5)	(1.4)	\$ (148.0)	(2.2)	\$ (83.7)	(1.3)
CarMax Auto Finance income	\$ 147.2	4.5	\$ 114.1	3.5	\$ 198.1	3.0	\$ 230.1	3.6

<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	
	2020	2019	2020	2019
Net loans originated <i>(in millions)</i>	\$ 1,790.6	\$ 1,772.6	\$ 2,782.9	\$ 3,598.9
Vehicle units financed	92,648	88,285	141,344	181,243
Net penetration rate <sup>(1)</sup>	42.6 %	42.2 %	40.1 %	41.8 %
Weighted average contract rate	8.2 %	8.6 %	8.3 %	8.7 %
Weighted average credit score <sup>(2)</sup>	710	708	709	706
Weighted average loan-to-value (LTV) <sup>(3)</sup>	91.6 %	94.7 %	92.1 %	94.5 %
Weighted average term <i>(in months)</i>	65.8	66.2	65.9	66.2

<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

<i>(In millions)</i>	As of and for the Three Months Ended August 31		As of and for the Six Months Ended August 31	
	2020	2019	2020	2019
Total ending managed receivables	\$ 13,379.0	\$ 13,131.5	\$ 13,379.0	\$ 13,131.5
Total average managed receivables	\$ 13,218.8	\$ 13,012.1	\$ 13,313.6	\$ 12,859.7
Allowance for loan losses <sup>(1)</sup>	\$ 432.5	\$ 150.4	\$ 432.5	\$ 150.4
Allowance for loan losses as a percentage of ending managed receivables	3.23 %	1.15 %	3.23 %	1.15 %
Net credit losses on managed receivables	\$ 30.7	\$ 42.1	\$ 75.3	\$ 71.5
Annualized net credit losses as a percentage of total average managed receivables	0.93 %	1.29 %	1.13 %	1.11 %
Past due accounts as a percentage of ending managed receivables	2.62 %	3.55 %	2.62 %	3.55 %
Average recovery rate <sup>(2)</sup>	57.3 %	48.6 %	52.0 %	48.9 %

- (1) The allowance for loan losses as of August 31, 2020, includes a \$202.0 million increase as a result of our adoption of CECL during the first quarter of fiscal 2021.*
- (2) 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 \$33.1 million, or 29.0% in the second quarter of fiscal 2021)
  - The increase in CAF income reflects a decrease in the provision for loan losses, as well as increases in the total interest margin percentage and average managed receivables.
  - The increase in net loan originations resulted from our used vehicle sales growth as well as an increase in CAF's net penetration rate, partially offset by a decrease in the average amount financed.
  
- CAF Income (Decrease of \$31.9 million or 13.9% in the first six months of fiscal 2021)
  - The decrease in CAF income reflects an increase in the provision for loan losses, partially offset by improvement in the total interest margin percentage.
  - The decrease in net loan originations resulted from our used vehicle sales decline as well as a decline in CAF's net penetration rate.
  
- Provision for Loan Losses (Decrease of \$19.5 million in the second quarter of fiscal 2021)
  - The decrease in the provision for loan losses was primarily due to favorable loss experience in comparison to our loss expectations set at the end of the first quarter, resulting in a \$29.6 million favorable adjustment for receivables then outstanding.
  - This adjustment was more than offset by a \$55.6 million increase to the provision related to our estimate of lifetime losses on originations during the second quarter.
  - While we experienced some loss favorability during the second quarter, this favorability was tempered by economic adjustment factors applied to the provision. The allowance for loan losses as of August 31, 2020 reflects the unpredictability of the current environment and the highly uncertain consumer situation.
  
- Provision for Loan Losses (Increase of \$64.3 million in the first six months of fiscal 2021)
  - The provision included \$93.7 million, which largely reflected our initial estimate of lifetime losses on loans originated in each quarter of the current fiscal year.
  - The provision also included a net increase of \$54.3 million in our estimate of lifetime losses on loans existing at the beginning of each quarter during the current fiscal year, largely resulting from COVID-19 turmoil and worsened economic factors.
  - In connection with our adoption of CECL during the first quarter of fiscal 2021, we recorded a \$202.0 million increase in the allowance for loan losses on the first quarter opening balance sheet, with a corresponding decrease of \$153.3 million, net of tax, in retained earnings.
  
- Total interest margin (Increased to 6.0% of average managed receivables for both the second quarter and first six months of fiscal 2021 from 5.7% for both the second quarter and first six months of fiscal 2020)
  - The increase in the total interest margin percentage for both the second quarter and first six months of fiscal 2021 was the result of lower funding costs.

***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. Historically, CAF has targeted originating approximately 5% of the total Tier 3 loan volume; however, this rate may vary over time based on market conditions. During the first quarter of fiscal 2021, we paused our CAF Tier 3 lending given the current economic outlook and uncertainty surrounding the COVID-19 outbreak. Subsequent to the end of the second quarter, we resumed our Tier 3 lending program. A total of \$146.1 million and \$167.5 million in CAF Tier 3 receivables were outstanding as of August 31, 2020 and February 29, 2020, 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, 2020 and February 29, 2020, approximately 10% of the total allowance for loan losses related to the outstanding CAF Tier 3 loan balances.

## **PLANNED FUTURE ACTIVITIES**

In the first quarter of fiscal 2021, we paused our store expansion strategy in response to the COVID-19 situation. We are resuming new store growth and anticipate opening between eight and ten stores in fiscal 2022.

## FINANCIAL CONDITION

### Liquidity and Capital Resources

Historically, our primary ongoing cash requirements have been 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.

During the first quarter of fiscal 2021, in response to the COVID-19 crisis, we took immediate and proactive measures to bolster our liquidity position and provide additional financial flexibility to improve our ability to meet our short-term liquidity needs. Those measures included drawing down additional funds on our revolving credit facility, pausing our stock repurchase program, pausing our store expansion strategy and actively aligning operating expenses to the current state of the business. We strengthened our overall financial position by selling through inventory and quickly aligning costs to lower sales volumes. As demand increased during the second quarter, we were able to build our saleable inventory by more than 50% and successfully ramped up to target levels in September. Subsequent to the end of the second quarter, we fully paid down the outstanding balance on our revolving credit facility and resumed our store expansion strategy and share repurchase program. Our current capital allocation strategy is to remain focused on growing the business while maintaining an appropriate amount of caution given the uncertainty that remains in the economic environment. Given the turnaround in our business, the strength of the credit markets and our solid balance sheet, we believe we have the appropriate liquidity, access to capital and financial strength to support our operations and continue investing in our omni and digital initiatives for the foreseeable future.

We currently target an adjusted debt-to-total capital ratio in a range of 35% to 45%. Our adjusted debt to capital ratio was modestly below our targeted range for the second quarter of fiscal 2021, when netting out our accumulated cash of approximately \$712 million. 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. Generally, 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 2021, net cash provided by operating activities totaled \$889.8 million, compared with cash used in operating activities of \$125.5 million in the prior year period. Our operating cash flows are significantly impacted by changes in auto loans receivable, which decreased \$188.6 million in the current year period compared with an increase of \$721.2 million in the prior year period.

The majority of the changes in auto loans receivable are accompanied by changes in non-recourse notes payable, which are issued to fund auto loans originated by CAF. Net payments on non-recourse notes payable were \$230.9 million in the current year period compared with net issuances of \$606.1 million in the prior year period and are separately reflected as cash from financing activities. Due to the presentation differences between auto loans receivable and non-recourse notes payable on the consolidated statements of cash flows, fluctuations in these amounts can have a significant impact on our operating and financing cash flows without affecting our overall liquidity, working capital or cash flows.

As of August 31, 2020, total inventory was \$2.82 billion, representing a decrease of \$21.5 million compared with the balance as of the start of the fiscal year. The decrease was primarily due to a decline in vehicle units reflecting the seasonal pattern in inventory levels. The decrease in units was partially offset by an increase in the average carrying cost of inventory as a result of higher acquisition costs, driven by market appreciation.

The change in net cash provided by (used in) operating activities for the first six months of the current fiscal year compared with the prior year period reflected the changes in auto loans receivable and inventory, as discussed above, and timing-related changes to other current assets and accounts payable, partially offset by a decrease in net earnings when excluding non-cash expenses, which include depreciation and amortization, share-based compensation expense and the provisions for loan losses and cancellation reserves.

Investing Activities. During the first six months of the fiscal year, net cash used in investing activities totaled \$92.4 million in fiscal 2021 compared with \$178.9 million in fiscal 2020. Capital expenditures were \$92.0 million in the current year period versus \$171.3 million in the prior year period. Capital expenditures primarily included store construction costs and store remodeling expenses. We maintain a multi-year pipeline of sites to support our store growth, so portions of capital spending in one year may relate to stores that we open in subsequent fiscal years. In response to COVID-19, we paused our store expansion and remodel strategy during the first quarter of fiscal 2021.



As of August 31, 2020, 141 of our 220 used car stores were located on owned sites and 79 were located on leased sites, including 23 land-only leases and 56 land and building leases.

**Financing Activities.** During the first six months of fiscal 2021, net cash used in financing activities totaled \$86.0 million compared with net cash provided by financing activities of \$346.6 million in the prior year period. Included in these amounts were net payments on non-recourse notes payable of \$230.9 million compared with net issuances of non-recourse notes payable of \$606.1 million in the prior year period. Non-recourse notes payable are typically used to fund changes in auto loans receivable (see “Operating Activities”).

During the first six months of fiscal 2021, cash used in financing activities was impacted by stock repurchases of \$54.2 million as well as net borrowings on our long-term debt of \$117.4 million. 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.

#### TOTAL DEBT AND CASH AND CASH EQUIVALENTS

<i>(In thousands)</i>		As of August 31	As of February 29
Debt Description <sup>(1)</sup>	Maturity Date	2020	2020
Revolving credit facility <sup>(2) (4)</sup>	June 2024	\$ 575,838	\$ 452,740
Term loan	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	533,165	536,739
Non-recourse notes payable	Various dates through May 2027	13,382,375	13,613,272
<b>Total debt <sup>(3)</sup></b>		<b>15,291,378</b>	<b>15,402,751</b>
Cash and cash equivalents		\$ 711,561	\$ 58,211

<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.

<sup>(4)</sup> On September 16, 2020, we fully paid down the outstanding borrowings under this facility with cash on hand.

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. As of August 31, 2020, we were in compliance with these financial covenants.

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

CAF auto loans receivable 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 loans receivable, 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 loans receivable. We do, however, continue to have the rights associated with the interest we retain in these non-recourse funding vehicles.

As of August 31, 2020, \$11.13 billion and \$2.25 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 2021, we funded a total of \$2.50 billion in asset-backed term funding transactions. As of August 31, 2020, we had \$1.25 billion of unused capacity in our warehouse facilities.

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.

The timing and amount of stock repurchases are determined based on stock price, market conditions, legal requirements and other factors. Shares repurchased are deemed authorized but unissued shares of common stock. As of August 31, 2020, a total of \$2 billion of board authorizations for repurchases was outstanding, with no expiration date, of which \$1.51 billion remained available for repurchase. In March 2020, our current stock repurchase program was suspended. The repurchase authorization remained effective and the program resumed in September 2020. 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 operating capacity, sales, market share, 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:

- The effect and consequences of COVID-19 on matters including U.S. and local economies; our business operations and continuity; the availability of corporate and consumer financing; the health and productivity of our associates; the ability of third-party providers to continue uninterrupted service; and the regulatory environment in which we operate.
- Changes in general or regional U.S. economic conditions.
- Changes in the availability or cost of capital and working capital financing, including changes related to the asset-backed securitization market.
- Changes in the 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.
- Our inability to realize the benefits associated with our omni-channel initiatives.
- 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 loans receivable 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 performance of third-party vendors we rely on for key components of our business.
- The effect of various litigation matters.
- Adverse conditions affecting one or more automotive manufacturers, and manufacturer recalls.
- The failure or inability to realize the benefits associated with our strategic investments.
- 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 failure or inability to adequately protect our intellectual property.
- 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 45 of this report, our Annual Report on Form 10-K for the fiscal year ended February 29, 2020, and our quarterly or current reports as filed with or furnished to the U.S. Securities and Exchange Commission (“SEC”). Our filings are publicly available on our investor information home page at [investors.carmax.com](http://investors.carmax.com). Requests for information may also be made to our Investor Relations Department by email to [investor\\_relations@carmax.com](mailto:investor_relations@carmax.com) or by calling 1-804-747-0422, ext. 4391. We undertake no obligation to update or revise any forward-looking statements after the date they are made, whether as a result of new information, future events or otherwise.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to our market risk since February 29, 2020. 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 29, 2020.

### 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, 2020, 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

As previously disclosed, in May 2020, we received a pre-filing negotiation request from the United States Environmental Protection Agency (EPA) with respect to alleged violations of the Clean Water Act related to the discharge of petroleum from a storage tank at a CarMax retail store location. The discharge was accidental and is being remediated. In September 2020, we reached an agreement with the EPA to resolve this matter with a civil penalty payment of \$119,440. Final EPA acceptance of the settlement is subject to a public comment period that will end in October 2020.

For additional 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 29, 2020, 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 other than the updated information related to the impact on our business from the COVID-19 outbreak included in this Form 10-Q.

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

None.

Item 6. Exhibits

- [10.1](#) CarMax, Inc. 2002 Stock Incentive Plan, as amended and restated June 23, 2020, filed as Exhibit 10.1 to CarMax's Current Report on Form 8-K, filed June 25, 2020.
- [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/ Enrique N. Mayor-Mora  
Enrique N. Mayor-Mora  
Senior Vice President and  
Chief Financial Officer

October 5, 2020