

CARMAX INC
Form 10-Q
October 08, 2014
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, 2014

OR

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

Commission File Number: 1-31420

CARMAX, INC.

(Exact name of registrant as specified in its charter)

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

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

(804) 747-0422

(Registrant's telephone number, including area code)

N/A

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

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

Yes No

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

Class Outstanding as of September 30, 2014

Common Stock, par value \$0.50	215,394,966
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CARMAX, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CARMAX, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings

(Unaudited)

(In thousands except per share data)	Three Months Ended August 31				Six Months Ended August 31			
	2014	% (1)	2013	% (1)	2014	% (1)	2013	% (1)
SALES AND OPERATING REVENUES:								
Used vehicle sales	\$ 2,920,165	81.1	\$ 2,639,523	81.3	\$ 5,980,506	81.4	\$ 5,341,278	81.5
New vehicle sales	69,944	1.9	60,002	1.8	139,733	1.9	112,429	1.7
Wholesale vehicle sales	530,270	14.7	474,907	14.6	1,075,515	14.6	965,566	14.7
Other sales and revenues	78,815	2.2	71,120	2.2	153,636	2.1	137,336	2.1
NET SALES AND OPERATING REVENUES								
	3,599,194	100.0	3,245,552	100.0	7,349,390	100.0	6,556,609	100.0
Cost of sales	3,135,855	87.1	2,810,809	86.6	6,384,320	86.9	5,673,770	86.5
GROSS PROFIT	463,339	12.9	434,743	13.4	965,070	13.1	882,839	13.5
CARMAX AUTO FINANCE INCOME								
Selling, general and administrative expenses	297,638	8.3	283,206	8.7	611,084	8.3	573,395	8.7
Interest expense	7,351	0.2	7,761	0.2	14,952	0.2	15,639	0.2
Other expense	283		1,073		560		832	
Earnings before income taxes	250,641	7.0	227,125	7.0	525,663	7.2	464,414	7.1
Income tax provision	96,123	2.7	86,851	2.7	201,492	2.7	177,489	2.7
NET EARNINGS	\$ 154,518	4.3	\$ 140,274	4.3	\$ 324,171	4.4	\$ 286,925	4.4
WEIGHTED AVERAGE COMMON SHARES:								
Basic	218,180		223,610		219,224		224,114	

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Diluted	221,070	227,634	222,351	228,093
NET EARNINGS PER SHARE:				
Basic	\$ 0.71	\$ 0.63	\$ 1.48	\$ 1.28
Diluted	\$ 0.70	\$ 0.62	\$ 1.46	\$ 1.26

(1) Calculated as a percentage of net sales and operating revenues and may not equal totals due to rounding.

See accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2014	2013	2014	2013
NET EARNINGS	\$ 154,518	\$ 140,274	\$ 324,171	\$ 286,925
Other comprehensive income, net of taxes:				
Net change in retirement benefit plan				
unrecognized actuarial losses	213	270	426	526
Net change in cash flow hedge				
unrecognized losses	1,096	3,331	1,378	5,373
Other comprehensive income, net of taxes	1,309	3,601	1,804	5,899
TOTAL COMPREHENSIVE INCOME	\$ 155,827	\$ 143,875	\$ 325,975	\$ 292,824

See accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	(Unaudited)	
	As of August 31 2014	As of February 28 2014
(In thousands except share data)		
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 354,600	\$ 627,901
Restricted cash from collections on auto loan receivables	297,068	259,299
Accounts receivable, net	108,859	79,923
Inventory	1,708,955	1,641,424
Deferred income taxes	8,275	7,866
Other current assets	38,685	26,811
TOTAL CURRENT ASSETS	2,516,442	2,643,224
Auto loan receivables, net	7,844,268	7,147,848
Property and equipment, net	1,753,992	1,652,977
Deferred income taxes	157,175	152,199
Other assets	128,036	110,909
TOTAL ASSETS	\$ 12,399,913	\$ 11,707,157
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 418,269	\$ 427,492
Accrued expenses and other current liabilities	205,480	202,588
Accrued income taxes	244	2,438
Short-term debt	2,229	582
Current portion of finance and capital lease obligations	20,280	18,459
Current portion of non-recourse notes payable	260,425	223,938
TOTAL CURRENT LIABILITIES	906,927	875,497
Finance and capital lease obligations, excluding current portion	310,689	315,925
Non-recourse notes payable, excluding current portion	7,648,284	7,024,506
Other liabilities	176,026	174,232
TOTAL LIABILITIES	9,041,926	8,390,160
Commitments and contingent liabilities		
SHAREHOLDERS' EQUITY:		
Common stock, \$0.50 par value; 350,000,000 shares authorized; 216,704,250 and 221,685,984 shares issued and outstanding as of August 31, 2014 and February 28, 2014, respectively	108,352	110,843

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Capital in excess of par value	1,089,317	1,038,209
Accumulated other comprehensive loss	(44,467)	(46,271)
Retained earnings	2,204,785	2,214,216
TOTAL SHAREHOLDERS' EQUITY	3,357,987	3,316,997
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 12,399,913	\$ 11,707,157

See accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	Six Months Ended August 31	
	2014	2013
OPERATING ACTIVITIES:		
Net earnings	\$ 324,171	\$ 286,925
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	55,766	49,160
Share-based compensation expense	37,778	38,002
Provision for loan losses	36,208	29,318
Provision for cancellation reserves	38,463	18,324
Deferred income tax benefit	(6,530)	(3,200)
Loss on disposition of assets and other	917	- 930
Net (increase) decrease in:		
Accounts receivable, net	(28,936)	6,412
Inventory	(67,531)	153,797
Other current assets	(11,706)	(746)
Auto loan receivables, net	(732,628)	(799,385)
Other assets	(313)	(6,736)
Net decrease in:		
Accounts payable, accrued expenses and other current liabilities and accrued income taxes	(36,052)	(13,913)
Other liabilities	(46,226)	(22,497)
NET CASH USED IN OPERATING ACTIVITIES	(436,619)	(263,609)
INVESTING ACTIVITIES:		
Capital expenditures	(135,293)	(136,011)
Proceeds from sales of assets	5,829	4,716
Increase in restricted cash from collections on auto loan receivables	(37,769)	(27,053)
Increase in restricted cash in reserve accounts	(6,640)	(5,319)
Release of restricted cash from reserve accounts	1,634	15,017
(Purchases) sales of money market securities, net	(8,753)	1,337
Purchases of trading securities	(3,107)	(1,405)
Sales of trading securities	306	33
NET CASH USED IN INVESTING ACTIVITIES	(183,793)	(148,685)
FINANCING ACTIVITIES:		
Increase in short-term debt, net	1,647	1,384
Payments on finance and capital lease obligations	(8,712)	(10,932)
Issuances of non-recourse notes payable	3,803,000	3,530,000
Payments on non-recourse notes payable	(3,142,735)	(2,654,658)
Repurchase and retirement of common stock	(373,362)	(179,278)
Equity issuances, net	37,483	14,753
Excess tax benefits from share-based payment arrangements	29,790	11,693
NET CASH PROVIDED BY FINANCING ACTIVITIES	347,111	712,962
(Decrease) increase in cash and cash equivalents	(273,301)	300,668
Cash and cash equivalents at beginning of year	627,901	449,364

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CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 354,600	\$ 750,032
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 15,029	\$ 15,714
Cash paid for income taxes	\$ 191,401	\$ 155,623
Non-cash investing and financing activities:		
Increase in accrued capital expenditures	\$ 18,173	\$ 19,745
Finance lease modifications	\$ 5,297	\$

See accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

1. Background

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

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

2. Accounting Policies

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

February 28, 2014.

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

Cash and Cash Equivalents. Cash equivalents of \$327.0 million as of August 31, 2014, and \$607.0 million as of February 28, 2014, consisted of highly liquid investments with original maturities of three months or less.

Restricted Cash from Collections on Auto Loan Receivables. Cash accounts totaling \$297.1 million as of August 31, 2014, and \$259.3 million as of February 28, 2014, consisted of collections of principal and interest payments on securitized auto loan receivables that are restricted for payment to the securitization investors pursuant to the applicable securitization agreements.

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

We typically use term securitizations to provide long-term funding for most of the auto loan receivables initially securitized through the warehouse facilities. In these transactions, a pool of auto loan receivables is sold to a bankruptcy-remote, special purpose entity that, in turn, transfers the receivables to a special purpose securitization trust. The securitization trust issues asset-backed securities, secured or otherwise supported by the transferred receivables, and the proceeds from the sale of the asset-backed securities are used to finance the securitized receivables.

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

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

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

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

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

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

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

expensed as incurred. See Note 3 for additional information on CAF income.

Property and Equipment, Net. Property and equipment is reported net of accumulated depreciation and amortization of \$778.7 million and \$730.6 million as of August 31, 2014 and February 28, 2014, respectively.

Other Assets. Other assets includes amounts classified as restricted cash on deposit in reserve accounts and restricted investments. The restricted cash on deposit in reserve accounts is for the benefit of holders of non-recourse notes payable, and these funds are not expected to be available to the company or its creditors. In the event that the cash generated by the securitized receivables in a given period was insufficient to pay the interest, principal and other required payments, the balances on deposit in the reserve accounts would be used to pay those amounts. Restricted cash on deposit in reserve accounts was \$37.5 million as of August 31, 2014, and \$32.5 million as of February 28, 2014.

Restricted investments includes money market securities primarily held to satisfy certain insurance program requirements, as well as investments held in a rabbi trust established to fund informally our executive deferred compensation plan. The rabbi trust investments are classified as trading securities with realized and unrealized gains and losses reflected as a component of other expense. Restricted investments was \$52.1 million as of August 31, 2014, and \$40.2 million as of February 28, 2014.

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

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

We sell EPP products on behalf of unrelated third parties to customers who purchase a vehicle. In May 2014, the ESPs we offer on all used vehicles were modified to provide coverage of 60 months (subject to mileage limitations). Prior to this modification, the ESPs we offered provided coverage up to 72 months. GAP covers the customer for the term of their finance contract. We recognize commission revenue at the time of sale, net of a reserve for estimated customer cancellations. Periodically, we may receive additional commissions based upon the level of underwriting profits of the third parties who administer the products. These additional commissions are recognized as revenue when received. The reserve for cancellations is evaluated for each product, and is based on forecasted forward cancellation curves utilizing historical experience, recent trends and credit mix of the customer base. Our risk related to customer cancellations is limited to the commissions that we receive. Cancellations fluctuate depending on the volume of EPP sales, customer financing default or prepayment rates, and shifts in customer behavior, including those related to changes in the coverage or term of the product. The current portion of estimated cancellation reserves is recognized as a component of other current liabilities with the remaining amount recognized in other liabilities. See Note 7 for additional information on cancellation reserves.

Customers applying for financing who are not approved by CAF may be evaluated by other financial institutions. Depending on the credit profile of the customer, third-party finance providers generally either pay us or are paid a fixed, pre-negotiated fee per contract. We recognize these fees at the time of sale.

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

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

3.CarMax Auto Finance Income

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

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

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

Components of CAF Income

Three Months	Six Months
Ended August	Ended
31	August 31

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(In millions)	2014	% (1)	2013	% (1)	2014	% (1)	2013	% (1)
Interest margin:								
Interest and fee income	\$ 150.7	7.8	\$ 137.2	8.4	\$ 297.6	7.9	\$ 270.7	8.5
Interest expense	(23.9)	(1.2)	(22.6)	(1.4)	(47.0)	(1.2)	(45.4)	(1.4)
Total interest margin	126.8	6.6	114.6	7.0	250.6	6.6	225.3	7.1
Provision for loan losses	(20.4)	(1.1)	(18.0)	(1.1)	(36.2)	(1.0)	(29.3)	(0.9)
Total interest margin after provision for loan losses	106.4	5.5	96.6	5.9	214.4	5.7	196.0	6.2
Other income			0.1				0.1	
Direct expenses:								
Payroll and fringe benefit expense	(6.3)	(0.3)	(5.6)	(0.3)	(12.5)	(0.3)	(11.1)	(0.4)
Other direct expenses	(7.5)	(0.4)	(6.7)	(0.4)	(14.7)	(0.4)	(13.6)	(0.4)
Total direct expenses	(13.8)	(0.7)	(12.3)	(0.7)	(27.2)	(0.7)	(24.7)	(0.8)
CarMax Auto Finance income	\$ 92.6	4.8	\$ 84.4	5.2	\$ 187.2	5.0	\$ 171.4	5.4
Total average managed receivables	\$ 7,724.5		\$ 6,516.3		\$ 7,557.3		\$ 6,334.4	

(1) Annualized percentage of total average managed receivables.

4. Auto Loan Receivables

Auto loan receivables include amounts due from customers related to retail vehicle sales financed through CAF and are presented net of an allowance for estimated loan losses. We use warehouse facilities to fund auto loan receivables originated by CAF until we elect to fund them through a term securitization or alternative funding arrangement. The majority of the auto loan receivables serve as collateral for the related non-recourse notes payable of \$7.91 billion as of August 31, 2014, and \$7.25 billion as of February 28, 2014. See Notes 2 and 10 for additional information on securitizations and non-recourse notes payable.

Auto Loan Receivables, Net

(In millions)	As of August 31 2014	As of February 28 2014
Warehouse facilities	\$ 1,045.0	\$ 879.0
Term securitizations	6,603.3	6,145.5
Other receivables (1)	242.7	159.9
Total ending managed receivables	7,891.0	7,184.4
Accrued interest and fees	31.8	26.3
Other	(0.7)	7.0

Less allowance for loan losses	(77.8)	(69.9)
Auto loan receivables, net	\$ 7,844.3	\$ 7,147.8

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

Credit Quality. When customers apply for financing, CAF's proprietary scoring models rely on the customers' credit history and certain application information to evaluate and rank their risk. Credit histories are obtained from credit bureau reporting agencies and include information such as number, age, type and payment history for prior or existing credit

accounts. The application information that is used includes income, collateral value and down payment. The scoring models yield credit grades that represent the relative likelihood of repayment. Customers assigned a grade of “A” are determined to have the highest probability of repayment, and customers assigned a lower grade are determined to have a lower probability of repayment. For loans that are approved, the credit grade influences the terms of the agreement, such as the required loan-to-value ratio and interest rate.

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

Ending Managed Receivables by Major Credit Grade

(In millions)	As of August 31		As of February 28	
	2014 (1)	% (2)	2014 (1)	% (2)
A	\$ 3,867.3	49.0	\$ 3,506.0	48.8
B	2,884.9	36.6	2,658.5	37.0
C and other	1,138.8	14.4	1,019.9	14.2
Total ending managed receivables	\$ 7,891.0	100.0	\$ 7,184.4	100.0

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

(2)Percentage of total ending managed receivables.

Allowance for Loan Losses

(In millions)	Three Months Ended August 31				Six Months Ended August 31			
	2014	% (1)	2013	% (1)	2014	% (1)	2013	% (1)
Balance as of beginning of period	\$ 75.4	1.00	\$ 60.9	0.96	\$ 69.9	0.97	\$ 57.3	0.97
Charge-offs	(36.9)		(31.8)		(68.9)		(58.2)	
Recoveries	18.9		18.8		40.6		37.5	
Provision for loan losses	20.4		18.0		36.2		29.3	
Balance as of end of period	\$ 77.8	0.99	\$ 65.9	0.99	\$ 77.8	0.99	\$ 65.9	0.99

(1)Percentage of total ending managed receivables as of the corresponding reporting date.

The allowance for loan losses represents an estimate of the amount of net losses inherent in our portfolio of managed receivables as of the applicable reporting date and anticipated to occur during the following 12 months. The

allowance is primarily based on the credit quality of the underlying receivables, historical loss trends and forecasted forward loss curves. We also take into account recent trends in delinquencies and losses, recovery rates and the economic environment. The provision for loan losses is the periodic expense of maintaining an adequate allowance.

Past Due Receivables

(In millions)	As of August 31		As of February 28	
	2014	% (1)	2014	% (1)
Total ending managed receivables	\$ 7,891.0	100.0	\$ 7,184.4	100.0
Delinquent loans:				
31-60 days past due	\$ 150.0	1.9	\$ 126.6	1.8
61-90 days past due	52.1	0.7	42.6	0.6
Greater than 90 days past due	17.9	0.2	16.0	0.2
Total past due	\$ 220.0	2.8	\$ 185.2	2.6

(1)Percentage of total ending managed receivables.

5.Derivative Instruments and Hedging Activities

Risk Management Objective of Using Derivatives. We are exposed to certain risks arising from both our business operations and economic conditions, particularly with regard to future issuances of fixed-rate debt and existing and future issuances of floating-rate debt. Primary exposures include LIBOR and other rates used as benchmarks in our securitizations. We enter into derivative instruments to manage exposures that arise from business activities that result in the future known receipt or payment of uncertain cash amounts, the values of which are impacted by interest rates. Our derivative instruments are used to manage differences in the amount of our known or expected cash receipts and our known or expected cash payments principally related to the funding of our auto loan receivables.

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

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

Designated Cash Flow Hedges. Our objectives in using interest rate derivatives are to add stability to CAF's interest expense, to manage our exposure to interest rate movements and to better match funding costs to the interest received on the fixed-rate receivables being securitized. To accomplish these objectives, we primarily use interest rate swaps that involve the receipt of variable amounts from a counterparty in exchange for our making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. These interest rate swaps are designated as cash flow hedges of forecasted interest payments in anticipation of permanent funding in the term securitization market.

For derivatives that are designated and qualify as cash flow hedges, the effective portion of changes in the fair value is initially recorded in accumulated other comprehensive loss (“AOCL”) and is subsequently reclassified into CAF income in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in CAF income. Amounts reported in AOCL related to derivatives will be reclassified to CAF income as interest expense is incurred on our future issuances of fixed-rate debt. During the next 12 months, we estimate that an additional \$11.0 million will be reclassified as a decrease to CAF income.

As of August 31, 2014 and February 28, 2014 we had interest rate swaps outstanding with combined notional amounts of \$1,021.0 million and \$869.0 million, respectively, which were designated as cash flow hedges of interest rate risk.

As of August 31, 2014 and February 28, 2014, we had no derivatives that were not designated as accounting hedges.

Fair Values of Derivative Instruments

(In thousands)	As of August 31, 2014		As of February 28, 2014	
	Assets	Liabilities	Assets	Liabilities
Derivatives designated as accounting hedges:				
Interest rate swaps (1)	\$ 94	\$	\$	\$
Interest rate swaps (2)	\$	\$ (1,211)	\$	\$ (1,351)
Total	\$ 94	\$ (1,211)	\$	\$ (1,351)

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

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

Effect of Derivative Instruments on Comprehensive Income

(In thousands)	Three Months Ended August 31		Six Months Ended August 31	
	2014	2013	2014	2013
Derivatives designated as accounting hedges:				
(Loss)/gain recognized in AOCL (1)	\$ (271)	\$ 2,890	\$ (2,069)	\$ 3,352
Loss reclassified from AOCL into CAF income (1)	\$ (2,076)	\$ (2,605)	\$ (4,339)	\$ (5,510)
Gain recognized in CAF Income (2)	\$	\$ 57	\$	\$ 78

(1) Represents the effective portion.

(2) Represents the ineffective portion.

6. Fair Value Measurements

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

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

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

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

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

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

Valuation Methodologies

Money Market Securities. Money market securities are cash equivalents, which are included in either cash and cash equivalents or other assets, and consist of highly liquid investments with original maturities of three months or less. We

use quoted market prices for identical assets to measure fair value. Therefore, all money market securities are classified as Level 1.

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

Derivative Instruments. The fair values of our derivative instruments are included in either other current assets or accounts payable. As described in Note 5, as part of our risk management strategy, we utilize derivative instruments to manage differences in the amount of our known or expected cash receipts and our known or expected cash payments principally related to the funding of our auto loan receivables. 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 the liquid market; however, because the models include inputs other than quoted prices in active markets, all derivatives are classified as Level 2.

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

Items Measured at Fair Value on a Recurring Basis

(In thousands)	As of August 31, 2014				
	Level 1	Level 2	Total		
Assets:					
Money market securities	\$ 370,384	\$	\$ 370,384		
Mutual fund investments	8,726		8,726		
Derivative instruments		94	94		
Total assets at fair value	\$ 379,110	\$ 94	\$ 379,204		
Percentage of total assets at fair value	100.0	%	%	100.0	%
Percentage of total assets	3.1	%	%	3.1	%
Liabilities:					
Derivative instruments	\$	\$ 1,211	\$ 1,211		
Total liabilities at fair value	\$	\$ 1,211	\$ 1,211		
Percentage of total liabilities		%	%		%

(In thousands)	As of February 28, 2014				
	Level 1	Level 2	Total		
Assets:					
Money market securities	\$ 641,622	\$	\$ 641,622		
Mutual fund investments	5,609		5,609		
Total assets at fair value	\$ 647,231	\$	\$ 647,231		
Percentage of total assets at fair value	100.0	%	%	100.0	%
Percentage of total assets	5.5	%	%	5.5	%
Liabilities:					
Derivative instruments	\$	\$ 1,351	\$ 1,351		
Total liabilities at fair value	\$	\$ 1,351	\$ 1,351		
Percentage of total liabilities		%	%		%

7.Cancellation Reserves

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

Cancellation Reserves

	Three Months Ended August 31		Six Months Ended August 31, 2014	
(In millions)	2014	2013	2014	2013

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Balance as of beginning of period	\$ 81.1	\$ 33.3	\$ 72.5	\$ 32.7
Cancellations	(12.5)	(8.5)	(25.0)	(17.0)
Provision for future cancellations	17.4	9.2	38.5	18.3
Balance as of end of period	\$ 86.0	\$ 34.0	\$ 86.0	\$ 34.0

8. Income Taxes

We had \$28.3 million of gross unrecognized tax benefits as of August 31, 2014, and \$26.3 million as of February 28, 2014. There were no significant changes to the gross unrecognized tax benefits as reported for the year ended February 28, 2014, as all activity was related to positions taken on tax returns filed or intended to be filed in the current fiscal year.

9. Retirement Plans

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

Components of Net Pension Expense

(In thousands)	Three Months Ended August 31					
	Pension Plan		Restoration Plan		Total	
	2014	2013	2014	2013	2014	2013
Interest cost	\$ 2,008	\$ 1,895	\$ 113	\$ 98	\$ 2,121	\$ 1,993
Expected return on plan assets	(2,247)	(1,978)			(2,247)	(1,978)
Recognized actuarial loss	340	429			340	429
Net pension expense	\$ 101	\$ 346	\$ 113	\$ 98	\$ 214	\$ 444

(In thousands)	Six Months Ended August 31					
	Pension Plan		Restoration Plan		Total	
	2014	2013	2014	2013	2014	2013
Interest cost	\$ 4,016	\$ 3,791	\$ 226	\$ 197	\$ 4,242	\$ 3,988
Expected return on plan assets	(4,514)	(3,958)			(4,514)	(3,958)
Recognized actuarial loss	680	837			680	837
Net pension expense	\$ 182	\$ 670	\$ 226	\$ 197	\$ 408	\$ 867

We made \$1.0 million in contributions to the pension plan during the six months ended August 31, 2014, and anticipate making \$1.3 million in contributions during the remainder of fiscal 2015. The expected long-term rate of return on plan assets for the pension plan was 7.75% as of February 28, 2014.

10. Debt

(In thousands)	As of	As of
	August 31	February 28
Short-term revolving credit facility	\$ 2,229	\$ 582
Current portion of finance and capital lease obligations	20,280	18,459

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Current portion of non-recourse notes payable	260,425	223,938
Total current debt	282,934	242,979
Finance and capital lease obligations, excluding current portion	310,689	315,925
Non-recourse notes payable, excluding current portion	7,648,284	7,024,506
Total debt, excluding current portion	7,958,973	7,340,431
Total debt	\$ 8,241,907	\$ 7,583,410

Revolving Credit Facility. Our \$700 million unsecured revolving credit facility (the “credit facility”) expires in August 2016. Borrowings under the credit facility are available for working capital and general corporate purposes. Borrowings accrue interest at variable rates based on LIBOR, the federal funds rate, or the prime rate, depending on the type of borrowing, and we pay a commitment fee on the unused portions of the available funds. As of August 31, 2014, the unused capacity of approximately \$698 million was fully available to us.

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

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

As of August 31, 2014, \$6.86 billion of non-recourse notes payable was outstanding related to term securitizations. These notes payable accrue interest at fixed rates and have scheduled maturities through February 2021, but may mature earlier or later, depending upon the repayment rate of the underlying auto loan receivables.

As of August 31, 2014, \$1.04 billion of non-recourse notes payable was outstanding related to our warehouse facilities. The combined warehouse facility limit was \$2.1 billion, and unused warehouse capacity totaled \$1.06 billion. In July 2014, we increased the combined limit of our warehouse facilities by an additional \$300 million. During the second quarter of fiscal 2015, we renewed our \$800 million warehouse facility that was scheduled to expire in August 2014 for an additional 364-day term. Of the combined warehouse facility limit, \$1.3 billion will expire in February 2015 and \$800 million will expire in July 2015. The return requirements of the warehouse facility investors could fluctuate significantly depending on market conditions. At renewal, the cost, structure and capacity of the facilities could change. These changes could have a significant impact on our funding costs.

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

Financial Covenants. The credit facility agreement contains representations and warranties, conditions and covenants. We must also meet financial covenants in conjunction with certain of the sale-leaseback transactions. Our securitization agreements contain representations and warranties, financial covenants and performance triggers. As of August 31, 2014, we were in compliance with all financial covenants and our securitized receivables were in compliance with the related performance triggers.

11. Stock and Stock-Based Incentive Plans

(A) Share Repurchase Program

In fiscal 2013, our board of directors authorized the repurchase of up to \$800 million of our common stock, and on April 4, 2014, we announced that they had authorized the repurchase of up to an additional \$1 billion of our common stock. During the quarter ended August 31, 2014, we exhausted the initial \$800 million authorization and, as of August 31, 2014, \$907.0 million was available for repurchase under the \$1 billion authorization, which expires on December 31, 2015.

For the three months ended August 31, 2014, we repurchased 4,024,801 shares of common stock at an average purchase price of \$49.92 per share. For the six months ended August 31, 2014, we repurchased 7,866,740 shares of common stock at an average purchase price of \$47.68 per share. For the three months ended August 31, 2013, we repurchased 1,046,629

shares of common stock at an average purchase price of \$46.54 per share. For the six months ended August 31, 2013, we purchased 3,992,251 shares of common stock at an average price of \$43.40 per share.

(B) Stock Incentive Plans

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

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

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

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

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

Restricted Stock Awards. Restricted stock awards (RSAs) are awards of our common stock that are subject to specified restrictions that lapse one year from the grant date. Participants holding RSAs are entitled to vote on matters submitted to holders of our common stock for a vote. During the six months ended August 31, 2014, we granted to our board of directors RSAs of 22,860 shares at a fair value per share on the grant date of \$51.18. No RSAs were outstanding during the six months ended August 31, 2013. The unrecognized compensation costs related to nonvested

RSAs totaled \$0.2 million as of August 31, 2014. These costs are expected to be recognized on a straight-line basis over a weighted average period of 0.8 years.

(C)Share-Based Compensation

Composition of Share-Based Compensation Expense

(In thousands)	Three Months Ended		Six Months Ended	
	August 31		August 31	
	2014	2013	2014	2013
Cost of sales	\$ 1,247	\$ 586	\$ 1,574	\$ 1,859
CarMax Auto Finance income	961	730	1,637	1,512
Selling, general and administrative expenses	20,493	14,063	35,209	35,237
Share-based compensation expense, before income taxes	\$ 22,701	\$ 15,379	\$ 38,420	\$ 38,608

Composition of Share-Based Compensation Expense – By Grant Type

Three	Six
Months	Months
Ended	Ended
August	August
31	31

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(In thousands)	2014	2013	2014	2013
Nonqualified stock options	\$ 6,887	\$ 5,786	\$ 15,007	\$ 12,819
Cash-settled restricted stock units	11,074	5,884	14,221	17,972
Stock-settled restricted stock units	3,472	2,891	7,593	6,711
Employee stock purchase plan	311	318	642	606
Restricted stock awards to non-employee directors	957		957	
Stock grants to non-employee directors		500		500
Share-based compensation expense, before income taxes	\$ 22,701	\$ 15,379	\$ 38,420	\$ 38,608

We recognize compensation expense for stock options, MSUs and RSAs on a straight-line basis (net of estimated forfeitures) over the requisite service period, which is generally the vesting period of the award. The variable expense associated with RSUs is recognized over their vesting period (net of estimated forfeitures) and is calculated based on the volume-weighted average price of our common stock on the last trading day of each reporting period. The total costs for matching contributions for our employee stock purchase plan are included in share-based compensation expense. There were no capitalized share-based compensation costs as of or for the six months ended August 31, 2014 or 2013.

Stock Option Activity

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
(Shares and intrinsic value in thousands)				
Outstanding as of February 28, 2014	10,018	\$ 27.02		
Options granted	2,003	44.96		
Options exercised	(2,591)	17.09		
Options forfeited or expired	(16)	32.69		
Outstanding as of August 31, 2014	9,414	\$ 33.56	4.4	\$ 177,333
Exercisable as of August 31, 2014	4,979	\$ 27.40	3.3	\$ 124,494

During the six months ended August 31, 2014 and 2013, we granted nonqualified options to purchase 2,003,238 and 1,601,699 shares of common stock, respectively. The total cash received as a result of stock option exercises for the six months ended August 31, 2014 and 2013, was \$44.3 million and \$20.8 million, respectively. We settle stock option exercises with authorized but unissued shares of our common stock. The total intrinsic value of options exercised for the six months ended August 31, 2014 and 2013, was \$85.9 million and \$29.5 million, respectively. We realized related tax benefits of \$34.6 million and \$11.8 million during the six months ended August 31, 2014 and 2013, respectively.

Outstanding Stock Options

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As of August 31, 2014

	Options Outstanding			Options Exercisable	
	Number of	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price	Number of	Weighted Average Exercise Price
(Shares in thousands)					
Range of Exercise Prices	Shares	Life (Years)	Price	Shares	Price
\$ 11.43	554	1.6	\$ 11.43	554	\$ 11.43
\$ 13.19 - \$ 19.82	488	0.9	\$ 15.57	488	\$ 15.57
\$ 19.98 - \$ 25.39	1,288	2.7	\$ 25.19	1,288	\$ 25.19
\$ 28.81 - \$ 32.69	3,511	4.2	\$ 32.12	2,181	\$ 32.22

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\$ 33.11 - \$ 49.25	3,573	6.1	\$ 43.89	468	\$ 42.21
Total	9,414	4.4	\$ 33.56	4,979	\$ 27.40

For stock options, the fair value of each award is estimated as of the date of grant using a binomial valuation model. In computing the value of the option, the binomial model considers characteristics of fair-value option pricing that are not available for consideration under a closed-form valuation model (for example, the Black-Scholes model), such as the contractual term of the option, the probability that the option will be exercised prior to the end of its contractual life and the probability of termination or retirement of the option holder. For this reason, we believe that the binomial model provides a fair value that is more representative of actual experience and future expected experience than the value calculated using a closed-form model. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the recipients of share-based awards.

The weighted average fair value per share at the date of grant for options granted during the six months ended August 31, 2014 and 2013, was \$13.21 and \$15.59, respectively. The unrecognized compensation costs related to nonvested options totaled \$43.7 million as of August 31, 2014. These costs are expected to be recognized on a straight-line basis over a weighted average period of 2.5 years.

Assumptions Used to Estimate Option Values

	Six Months Ended August 31	
	2014	2013
Dividend yield	0.0 %	0.0 %
Expected volatility factor (1)	25.2 % - 32.7 %	28.1 % - 46.8 %
Weighted average expected volatility	31.9 %	44.7 %
Risk-free interest rate (2)	0.03 % - 2.7 %	0.02 % - 2.6 %
Expected term (in years) (3)	4.7	4.7

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

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

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

Cash-Settled Restricted Stock Unit Activity

(Units in thousands)	Weighted Average Number Grant of Date Units Fair Value	

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Outstanding as of February 28, 2014	1,531	\$ 35.68
Stock units granted	588	\$ 44.96
Stock units vested and converted	(463)	\$ 32.77
Stock units cancelled	(65)	\$ 38.86
Outstanding as of August 31, 2014	1,591	\$ 39.82

During the six months ended August 31, 2014 and 2013, we granted 587,511 and 541,819 RSUs, respectively. The initial fair market value per RSU at the date of grant for the RSUs granted during the six months ended August 31, 2014 and 2013, was \$44.96 and \$42.68, respectively. The RSUs are cash-settled upon vesting. During the six months ended August 31, 2014 we paid \$21.2 million and \$23.0 million, respectively (before payroll tax withholdings), to RSU holders upon the vesting of RSUs. We realized tax benefits of \$8.6 million and \$9.2 million during the six months ended August 31, 2014 and 2013, respectively.

Expected Cash Settlement Range Upon Restricted Stock Unit Vesting

(In thousands)	As of August 31, 2014	
	Minimum (1)	Maximum
Fiscal 2016	\$ 12,376	\$ 33,003
Fiscal 2017	14,100	37,600
Fiscal 2018	16,285	43,428
Total expected cash settlements	\$ 42,761	\$ 114,031

(1) Net of estimated forfeitures.

Stock-Settled Restricted Stock Unit Activity

(Units in thousands)	Weighted Average	
	Number of Units	Grant Date Fair Value
Outstanding as of February 28, 2014	852	\$ 45.26
Stock units granted	245	\$ 55.37
Stock units vested and converted	(289)	\$ 45.65
Stock units cancelled		\$
Outstanding as of August 31, 2014	808	\$ 48.18

During the six months ended August 31, 2014 and 2013, we granted 245,190 and 236,675 MSUs, respectively. The weighted average fair value per MSU at the date of grant for MSUs granted during the six months ended August 31, 2014 and 2013, was \$55.37 and \$51.98, respectively. The fair values were determined using a Monte-Carlo simulation and were based on the expected market price of our common stock on the vesting date and the expected number of converted common shares. We realized related tax benefits of \$7.4 million and \$6.7 million for the six months ended August 31, 2014 and 2013, respectively, from the vesting of market stock units. The unrecognized compensation costs related to nonvested MSUs totaled \$19.0 million as of August 31, 2014. These costs are expected to be recognized on a straight-line basis over a weighted average period of 1.4 years.

12. Net Earnings per Share

Basic net earnings per share is computed by dividing net earnings available for basic common shares by the weighted average number of shares of common stock outstanding. Diluted net earnings per share is computed by dividing net earnings available for diluted common shares by the sum of weighted average number of shares of common stock outstanding and dilutive potential common stock.

Basic and Dilutive Net Earnings Per Share Reconciliations

	Three Months Ended		Six Months Ended	
	August 31		August 31	
(In thousands except per share data)	2014	2013	2014	2013
Net earnings	\$ 154,518	\$ 140,274	\$ 324,171	\$ 286,925
Weighted average common shares outstanding	218,180	223,610	219,224	224,114
Dilutive potential common shares:				
Stock options	2,269	3,319	2,520	3,257
Stock-settled restricted stock units and awards	621	705	607	722
Weighted average common shares and dilutive potential common shares	221,070	227,634	222,351	228,093

Basic net earnings per share	\$ 0.71	\$ 0.63	\$ 1.48	\$ 1.28
Diluted net earnings per share	\$ 0.70	\$ 0.62	\$ 1.46	\$ 1.26

Certain weighted-average 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. For the three months ended August 31, 2014 and 2013, weighted-average options to purchase 2,885,903 shares and 1,426,163 shares of common stock, respectively, were not included. For the six months ended August 31, 2014 and 2013, weighted-average options to purchase 2,586,357 shares and 1,073,635 shares respectively, were not included.

13. Accumulated Other Comprehensive Loss

Changes in Accumulated Other Comprehensive Loss by Component

(In thousands, net of income taxes)	Net Unrecognized Actuarial Losses	Net Unrecognized Hedge Losses	Total Accumulated Other Comprehensive Loss
Balance as of February 28, 2014	\$ (38,715)	\$ (7,556)	\$ (46,271)
Other comprehensive loss before reclassifications		(1,255)	(1,255)
Amounts reclassified from accumulated other comprehensive loss	426	2,633	3,059
Other comprehensive income	426	1,378	1,804
Balance as of August 31, 2014	\$ (38,289)	\$ (6,178)	\$ (44,467)

Changes In and Reclassifications Out of Accumulated Other Comprehensive Loss

(In thousands)	Three Months		Six Months	
	Ended August		Ended August	
	31	31	31	31
	2014	2013	2014	2013
Retirement Benefit Plans (Note 9):				
Actuarial loss amortization reclassifications recognized in net pension expense:				
Cost of sales	\$ 138	\$ 172	\$ 276	\$ 334
CarMax Auto Finance income	8	10	15	19
Selling, general and administrative expenses	194	247	389	484
Total amortization reclassifications recognized in net pension expense	340	429	680	837
Tax expense	(127)	(159)	(254)	(311)
Amortization reclassifications recognized in net pension expense, net of tax	213	270	426	526
Net change in retirement benefit plan unrecognized actuarial losses, net of tax	213	270		