CARMAX INC
Form 10-Q
January 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended November 30, 2011

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 incorporation or organization)	**(I.R.S. Employer Identification No.)**

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 x 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 x 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	x	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 x

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 December 31, 2011**
Common Stock, par value $0.50	**226,585,869**

A Table of Contents is included on Page 2 and a separate Exhibit Index is included on Page 41.

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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)

	Three Months Ended November 30				Nine Months Ended November 30			
(In thousands except per share data)	**2011**	**% (1)**	**2010**	**% (1)**	**2011**	**% (1)**	**2010**	**% (1)**
SALES AND OPERATING REVENUES:								
Used vehicle sales	$ 1,766,690	78.2	$ 1,688,469	79.7	$ 5,853,213	77.8	$ 5,410,133	80.5
New vehicle sales	45,997	2.0	47,671	2.2	154,736	2.1	149,626	2.2
Wholesale vehicle sales	390,262	17.3	320,117	15.1	1,325,926	17.6	966,495	14.4
Other sales and revenues	57,565	2.5	62,872	3.0	193,875	2.6	196,667	2.9
NET SALES AND OPERATING REVENUES	2,260,514	100.0	2,119,129	100.0	7,527,750	100.0	6,722,921	100.0
Cost of sales	1,957,295	86.6	1,821,219	85.9	6,487,161	86.2	5,742,345	85.4
GROSS PROFIT	303,219	13.4	297,910	14.1	1,040,589	13.8	980,576	14.6
CARMAX AUTO FINANCE INCOME	62,625	2.8	55,745	2.6	196,112	2.6	165,844	2.5
Selling, general and administrative expenses	232,304	10.3	219,707	10.4	716,944	9.5	671,635	10.0
Interest expense	780		801		2,358		2,286	
Other income (expense)	(94)		198		119		380	
Earnings before income taxes	132,666	5.9	133,345	6.3	517,518	6.9	472,879	7.0
Income tax provision	49,872	2.2	50,981	2.4	196,541	2.6	181,511	2.7
NET EARNINGS	$ 82,794	3.7	$ 82,364	3.9	$ 320,977	4.3	$ 291,368	4.3
WEIGHTED AVERAGE COMMON SHARES:								
Basic	226,446		223,953		226,104		223,007	
Diluted	230,632		228,471		230,529		226,924	
NET EARNINGS PER SHARE:								
Basic	$ 0.37		$ 0.37		$ 1.42		$ 1.30	
Diluted	$ 0.36		$ 0.36		$ 1.39		$ 1.28	

(1) *Percents are 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.

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CARMAX, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands except share data)	(Unaudited) November 30, 2011	February 28, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 383,411	$ 41,121
Restricted cash from collections on auto loan receivables	174,392	161,052
Accounts receivable, net	54,522	119,597
Inventory	1,013,183	1,049,477
Deferred income taxes	13,085	5,191
Other current assets	9,806	33,660
TOTAL CURRENT ASSETS	1,648,399	1,410,098
Auto loan receivables, net	4,807,804	4,320,575
Property and equipment, net	988,300	920,045
Deferred income taxes	87,705	92,278
Other assets	101,193	96,913
TOTAL ASSETS	$ 7,633,401	$ 6,839,909
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 246,393	$ 269,763
Accrued expenses and other current liabilities	123,074	103,389
Accrued income taxes	13,069	772
Short-term debt	759	1,002
Current portion of long-term debt	838	772
Current portion of non-recourse notes payable	147,183	132,519
TOTAL CURRENT LIABILITIES	531,316	508,217
Long-term debt, excluding current portion	27,713	28,350
Non-recourse notes payable, excluding current portion	4,318,046	3,881,142
Other liabilities	119,474	130,570
TOTAL LIABILITIES	4,996,549	4,548,279
Commitments and contingent liabilities		
SHAREHOLDERS EQUITY:		
Common stock, $0.50 par value; 350,000,000 shares authorized; 226,473,420 and 225,885,693 shares issued and outstanding as of November 30, 2011 and February 28, 2011, respectively	113,237	112,943
Capital in excess of par value	858,790	820,639
Accumulated other comprehensive loss	(39,257)	(25,057)
Retained earnings	1,704,082	1,383,105
TOTAL SHAREHOLDERS EQUITY	2,636,852	2,291,630
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 7,633,401	$ 6,839,909

See accompanying notes to consolidated financial statements.

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CARMAX, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	Nine Months Ended November 30 2011	2010
OPERATING ACTIVITIES:		
Net earnings	$ 320,977	$ 291,368
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	48,021	43,657
Share-based compensation expense	37,148	33,600
Provision for loan losses	24,878	18,450
Loss on disposition of assets	1,331	443
Deferred income tax (benefit) provision	(3,858)	14,352
Net decrease (increase) in:		
Accounts receivable, net	65,075	13,014
Retained interest in securitized receivables		43,746
Inventory	36,294	(159,849)
Other current assets	24,038	(15,879)
Auto loan receivables, net	(512,107)	(249,427)
Other assets	(5,075)	(5,984)
Net decrease in:		
Accounts payable, accrued expenses and other current liabilities and accrued income taxes	(21,673)	(48,602)
Other liabilities	(17,476)	(1,377)
NET CASH USED IN OPERATING ACTIVITIES	(2,427)	(22,488)
INVESTING ACTIVITIES:		
Capital expenditures	(105,990)	(38,536)
Proceeds from sales of assets		8
Increase in restricted cash from collections on auto loan receivables	(13,340)	(3,177)
Increase in restricted cash in reserve accounts	(8,573)	(11,310)
Release of restricted cash from reserve accounts	12,088	11,421
(Purchases) sales of money market securities, net	(520)	4,001
Purchases of investments available-for-sale	(2,252)	
Sales of investments available-for-sale	52	
NET CASH USED IN INVESTING ACTIVITIES	(118,535)	(37,593)
FINANCING ACTIVITIES:		
Decrease in short-term debt, net	(243)	(206)
Issuances of long-term debt		243,300
Payments on long-term debt	(571)	(365,451)
Issuances of non-recourse notes payable	3,633,000	2,947,000
Payments on non-recourse notes payable	(3,181,432)	(2,747,710)
Equity issuances, net	5,039	31,945
Excess tax benefits from share-based payment arrangements	7,459	7,316
NET CASH PROVIDED BY FINANCING ACTIVITIES	463,252	116,194
Increase in cash and cash equivalents	342,290	56,113
Cash and cash equivalents at beginning of year	41,121	18,278

CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 383,411	$ 74,391

See accompanying notes to consolidated financial statements.

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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 were the first used vehicle retailer to offer a large selection of high quality used vehicles at competitively low, no-haggle prices using a customer-friendly sales process in an attractive, modern sales facility. At select locations we also sell new vehicles under various franchise agreements. We provide customers with a full range of related products and services, including the financing of vehicle purchases through our own finance operation, CarMax Auto Finance (CAF), and third-party financing providers; the sale of extended service plans (ESP), a guaranteed asset protection (GAP) product and accessories; the appraisal and purchase of vehicles directly from consumers; 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.

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, 2011.

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

Cash and Cash Equivalents. Cash equivalents of $372.2 million as of November 30, 2011, and $23.9 million as of February 28, 2011, consisted of highly liquid investments with original maturities of three months or less.

Restricted Cash from Collections on Auto Loan Receivables. Cash accounts totaling $174.4 million as of November 30, 2011, and $161.1 million as of February 28, 2011, 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. As of March 1, 2010, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) Nos. 2009-16 and 2009-17 (formerly Statements of Financial Accounting Standards Nos. 166 and 167, respectively) with prospective application. ASU No. 2009-16 amended FASB Accounting Standards Codification (ASC) Topic 860, Transfers and Servicing, and ASU No. 2009-17 amended FASB ASC Topic 810, Consolidation. ASU No. 2009-16 removed the concept of a qualifying special-purpose entity (QSPE) from Topic 860 and removed the provision within Topic 810 exempting these entities from consolidation. These pronouncements also clarified the requirements for isolation and the limitations on the portions of financial assets that are eligible for sale accounting treatment.

Effective March 1, 2010, we recognize transfers of auto loan receivables into term securitizations as secured borrowings, which results in recording the auto loan receivables and the related non-recourse notes payable to the investors on our consolidated balance sheets. All transfers of receivables into our warehouse facilities on or after March 1, 2010, are also accounted for as secured borrowings. As of March 1, 2010, we amended our warehouse facility agreement in effect as of that date. As a result, auto loan receivables previously securitized through that warehouse facility no longer qualify for sale treatment because, under the amendment, CarMax now has effective control over the receivables. The receivables that were funded in the warehouse facility at that date were consolidated, at their fair value, along with the related non-recourse notes payable to the investors.

Beginning in fiscal 2011, CAF income no longer includes a gain on the sale of loans through securitization transactions, but instead primarily reflects the interest and fee income generated by the auto loan receivables less the interest expense associated with the non-recourse notes payable issued to fund these receivables, direct CAF expenses and a provision for estimated loan losses. See Notes 3 and 5 for additional information on securitizations.

Auto Loan Receivables, Net. Auto loan receivables include amounts due from customers primarily related to used retail vehicle sales financed through CAF and 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. See Note 3 for a summary of CAF income.

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. 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 6 for additional information on derivative instruments and hedging activities.

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 the securitization investors. 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. These funds are restricted for the benefit of holders of non-recourse notes payable and are not expected to be available to the company or its creditors. Restricted cash on deposit in reserve accounts was $41.5 million as of November 30, 2011, and $45.0 million as of February 28, 2011. See Note 5 for additional information on securitizations.

Restricted investments includes money market securities primarily associated with certain insurance programs and mutual funds held in a rabbi trust established in May 2011 to fund informally our executive deferred compensation plan. Restricted investments was $30.8 million as of November 30, 2011, and $26.7 million as of February 28, 2011.

Recent Accounting Pronouncements. In April 2011, the FASB issued an accounting pronouncement related to transfers and servicing (FASB ASC Topic 860), which removes the assessment of effective control criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. The guidance in this pronouncement is effective prospectively for transactions, or modifications of existing transactions, that occur on or after the first interim or annual period beginning on or after December 15, 2011. We will adopt this pronouncement for our fiscal year beginning March 1, 2012. We do not expect this pronouncement to have a material effect on our consolidated financial statements.

In May 2011, the FASB issued an accounting pronouncement related to fair value measurement (FASB ASC Topic 820), which amends current guidance to achieve common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. The amendments generally represent clarification of FASB ASC Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing

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information about fair value measurements has changed. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We will adopt this pronouncement for our fiscal year beginning March 1, 2012. We do not expect this pronouncement to have a material effect on our consolidated financial statements.

In June 2011, the FASB issued an accounting pronouncement, as amended December 2011, that provides new guidance on the presentation of comprehensive income (FASB ASC Topic 220) in financial statements. Entities are required to present total comprehensive income either in a single, continuous statement of comprehensive income or in two separate, but consecutive, statements. Under the single-statement approach, entities must include the components of net income, a total for net income, the components of other comprehensive income and a total for comprehensive income. Under the two-statement approach, entities must report an income statement and, immediately following, a statement of other comprehensive income. Under either method, entities may present reclassification adjustments out of accumulated other comprehensive income on the face of the statement or disclose the reclassification adjustments in the notes to the financial statements. The provisions for this pronouncement as amended are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. We will adopt this amended pronouncement for our fiscal year beginning March 1, 2012.

In September 2011, the FASB issued an accounting pronouncement related to intangibles goodwill and other (FASB ASC Topic 350), which allows for companies to first consider qualitative factors as a basis for assessing impairment and determining the necessity of a detailed impairment test. The provisions for this pronouncement are effective for fiscal years beginning after December 15, 2011, with early adoption permitted. We will adopt this pronouncement for our fiscal year beginning March 1, 2012. We do not expect this pronouncement to have a material effect on our consolidated financial statements.

In December 2011, the FASB issued an accounting pronouncement related to offsetting of assets and liabilities on the balance sheet (FASB ASC Topic 210). The amendments require additional disclosures related to offsetting either in accordance with U.S. GAAP or master netting arrangements. The provisions for this pronouncement are effective for fiscal years, and interim periods within those years, beginning after January 1, 2013. We will adopt this pronouncement for our fiscal year beginning March 1, 2013.

3. CarMax Auto Finance Income

	Three Months Ended Nov 30				Nine Months Ended Nov 30			
(In millions)	**2011**	**%** (1)	**2010**	**%** (1)	**2011**	**%** (1)	**2010**	**%** (1)
Interest margin:								
Interest and fee income	$ 114.3	9.6	$ 106.8	10.0	$ 334.0	9.7	$ 314.1	10.0
Interest expense	(25.6)	(2.2)	(33.0)	(3.1)	(80.3)	(2.3)	(103.4)	(3.3)
Total interest margin	88.7	7.4	73.8	6.9	253.7	7.4	210.7	6.7
Provision for loan losses	(15.1)	(1.3)	(8.6)	(0.8)	(24.9)	(0.7)	(18.5)	(0.6)
Total interest margin after provision for loan losses	73.6	6.2	65.2	6.1	228.8	6.7	192.2	6.1
Other income:								
Servicing fee income							0.9	
Interest income on retained interest in securitized receivables							1.6	0.1
Other gain	0.3		1.8	0.2	1.4		4.3	0.1
Total other income	0.3		1.8	0.2	1.4		6.8	0.2
Direct expenses:								
Payroll and fringe benefit expense	(5.1)	(0.4)	(5.1)	(0.5)	(15.5)	(0.5)	(15.4)	(0.5)
Other direct expenses	(6.2)	(0.5)	(6.2)	(0.6)	(18.6)	(0.5)	(17.8)	(0.6)
Total direct expenses	(11.3)	(0.9)	(11.3)	(1.1)	(34.1)	(1.0)	(33.2)	(1.1)

CarMax Auto Finance income	$ 62.6	5.3	$ 55.7	5.2	$ 196.1	5.7	$ 165.8	5.3
Total average managed receivables, principal only	$ 4,770.9		$ 4,285.3		$ 4,585.1		$ 4,204.6	

(1) *Annualized percent of total average managed receivables, principal only.*

CAF provides financing for qualified customers at competitive market rates of interest. We securitize substantially all of the loans originated by CAF as discussed in Note 5. CAF income primarily reflects the interest and fee income generated by the auto loan receivables less the interest expense associated with the non-recourse notes payable issued to fund these receivables, a provision for estimated loan losses and direct CAF expenses.

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CAF income does not include any allocation of indirect costs or income. We present this information on a direct basis to avoid making arbitrary decisions regarding the indirect benefits or costs that could be attributed to CAF. Examples of indirect costs not included are retail store expenses and corporate expenses such as human resources, administrative services, marketing, information systems, accounting, legal, treasury and executive payroll.

4. Auto Loan Receivables

Auto loan receivables include amounts due from customers primarily related to used 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 they are funded through a term securitization or alternative funding arrangement. See Note 5 for additional information on securitizations.

Auto Loan Receivables, Net

	$000.000.	$000.000.	$000.000.	$000.000.
	As of November 30		As of February 28	
(In millions)	2011	2010	2011	2010
Warehouse facilities [1]	$ 876.0	$ 542.0	$ 943.0	$ 331.0
Term securitizations [1]	3,697.1	3,599.9	3,193.1	3,615.6
Other receivables [2]	250.7	146.2	198.5	166.1
Total ending managed receivables	4,823.8	4,288.1	4,334.6	$ 4,112.7
Accrued interest and fees	24.3	23.2	20.9	
Other	1.1	5.5	4.0	
Less allowance for loan losses	(41.4)	(42.2)	(38.9)	
Auto loan receivables, net	$ 4,807.8	$ 4,274.6	$ 4,320.6	

(1) *Amounts were off-balance sheet prior to March 1, 2010.*

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

Credit Quality. When customers apply for financing, CAF uses proprietary scoring models that rely on the customers prior credit history and certain application information to evaluate and rank their risk. Prior credit history is obtained from credit bureau reporting agencies and 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. Our 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

$000.0000.	$000.0000.	$000.0000.	$000.0000.

(In millions)		As of November 30 2011 [1]	% [2]		As of February 28 2011 [1]	% [2]
A	$	2,401.4	49.8	$	2,234.1	51.5
B		1,860.3	38.6		1,668.0	38.5
C and other		562.1	11.6		432.5	10.0
Total ending managed receivables	$	4,823.8	100.0	$	4,334.6	100.0

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

(2) *Percent of total ending managed receivables.*

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Allowance for Loan Losses

(In millions)	Nine Months Ended November 30 2011	% [1]
Balance as of beginning of period	$ 38.9	0.9
Charge-offs	(67.1)	
Recoveries	44.7	
Provision for loan losses	24.9	
Balance as of end of period	$ 41.4	0.9

[1] *Percent 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 November 30 2011	% [1]	As of February 28 2011	% [1]
Total ending managed receivables	$ 4,823.8	100.0	$ 4,334.6	100.0
Delinquent loans:				
31-60 days past due	$ 103.3	2.2	$ 86.6	2.0
61-90 days past due	28.4	0.6	24.2	0.6
Greater than 90 days past due	10.6	0.2	10.5	0.2
Total past due	$ 142.3	3.0	$ 121.3	2.8

[1] *Percent of total ending managed receivables.*

5. Securitizations

Securitization Financing. 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 they are funded 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 (bank conduits). The bank conduits generally issue asset-backed commercial paper supported by the transferred receivables, and the proceeds from the sale of the commercial paper are used to finance the securitized receivables.

The bank conduits may be considered variable interest entities, but are not consolidated because our interest does not constitute a variable interest in the entities. We hold a variable interest in specified assets transferred to the entities rather than interests in the entities themselves.

We typically use term securitizations to provide long-term funding for 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. Depending on the transaction structure and market conditions, refinancing receivables in a term securitization could affect our results of operations.

The warehouse facilities and the term securitizations are governed by various legal documents that limit and specify the activities of the special purpose entities and term securitization trusts (collectively, securitization vehicles) used to facilitate the securitizations. The securitization vehicles are generally allowed to acquire the receivables being sold to them, issue asset-backed securities to investors to fund the acquisition of the receivables and enter into derivatives or other yield maintenance contracts to hedge or mitigate certain risks related to the pool of receivables or asset-backed securities. Additionally, the securitization vehicles are required to service the receivables they hold and the securities they have issued. These servicing functions are performed by CarMax, as appointed within the underlying legal documents. Servicing functions include, but are not limited to, collecting payments from borrowers, monitoring delinquencies, liquidating assets, investing funds until distribution, remitting payments to the trustee who in turn remits payments to the investors, and accounting for and reporting information to investors.

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.

On June 17, 2011, CarMax Auto Funding LLC (a subsidiary of CarMax, Inc.) filed a registration statement with the Securities and Exchange Commission to address the inadvertent offer and sale of asset-backed notes by CarMax Auto Owner Trust 2011-1 in March 2011 under an expired registration statement. As a result, on August 1, 2011, CarMax Auto Funding LLC offered to rescind purchases of the asset-backed notes sold. The rescission offer period expired on August 31, 2011, and none of the initial note purchasers opted to accept our offer. Accordingly, CarMax Auto Funding LLC did not repurchase any of the asset-backed notes.

Except as described above, we have not provided financial or other support to the securitization vehicles or investors 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.

Financial Covenants and Performance Triggers. The securitization agreements related to the warehouse facilities include various financial covenants and performance triggers. The financial covenants include a maximum net leverage ratio and a minimum interest and rent coverage ratio. Performance triggers require that the pools of securitized receivables in the warehouse facilities achieve specified thresholds related to loss and delinquency rates. If these financial covenants and/or thresholds are not met, we could be unable to continue to securitize receivables through the warehouse facilities. In addition, the warehouse facility investors could charge us a higher rate of interest and could have us replaced as servicer. Further, we could be required to deposit collections on the securitized receivables with the warehouse facility agents on a daily basis and deliver executed lockbox agreements to the warehouse facility agents. As of November 30, 2011, we were in compliance with the financial covenants and the securitized receivables were in compliance with the performance triggers.

Continuing Involvement with Securitized Receivables. We continue to manage the auto loan receivables that we securitize. We receive servicing fees of approximately 1% of the outstanding principal balance of the securitized receivables. We believe that the servicing fees specified in the securitization agreements adequately compensate us for servicing the securitized receivables. No servicing asset or liability has been recorded.

Transition. Effective March 1, 2010, all transfers of auto loan receivables related to the warehouse facilities are accounted for as secured borrowings. These transfers represent only a portion of the auto loan receivables and this portion does not meet the definition of a participating interest because our interest in the transferred receivables is subordinate to the interest of the investors in the bank conduits.

As of March 1, 2010, we amended our warehouse facility agreement in effect as of that date. As a result, auto loan receivables previously securitized through that warehouse facility no longer qualify for sale treatment because, under the amendment, CarMax now has effective control over the receivables. The receivables that were funded in the warehouse facility at that date were consolidated, at their fair value, along with the related non-recourse notes payable to the investors.

With the removal of the QSPE consolidation exemption from FASB ASC Topic 810, effective March 1, 2010, we are required to evaluate existing and future 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 receivables. 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, effective March 1, 2010. The auto loan receivables securitized through the term securitization trusts were consolidated at their unpaid principal balances as of that date, net of an allowance for loan losses, along with the related non-recourse notes payable to the investors.

In accordance with FASB ASC Topic 810, ending managed receivables was $4.82 billion as of November 30, 2011, and $4.33 billion as of February 28, 2011. The majority of these amounts serve as collateral for the related non-recourse notes payable of $4.47 billion and $4.01 billion as of the same dates, respectively. See Notes 4 and 10 for additional information on auto loan receivables and non-recourse notes payable.

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Retained Interest. Prior to March 1, 2010, all transfers of auto loan receivables were accounted for as sales. When the receivables were securitized, we recognized a gain on the sale and retained an interest in the receivables that were securitized. The retained interest included the present value of the expected residual cash flows generated by the securitized receivables, or interest-only strip receivables, various reserve accounts, required excess receivables and retained subordinated bonds. As of November 30, 2011, and February 28, 2011, there was no retained interest, as all transfers of auto loan receivables were accounted for as secured borrowings.

As part of the adoption of ASU Nos. 2009-16 and 2009-17, as of March 1, 2010, any retained interest related to term securitizations was either eliminated or reclassified, generally to auto loan receivables, accrued interest receivable or restricted cash. On March 1, 2010, we also amended our existing warehouse facility agreement. However, this did not result in the elimination or reclassification of the retained interest related to the receivables that were funded in the warehouse facility as of that date. In May 2010, we repurchased the remaining portion of those receivables and resecuritized them through our second warehouse facility established in the first quarter of fiscal 2011. As a result, the retained interest related to these receivables was either eliminated or reclassified at that time. See Note 10 for additional information on our warehouse facilities.

6. 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 value of which are determined 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 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.

Cash Flow Hedges of Interest Rate Risk. Our objectives in using interest rate derivatives are to add stability to 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. Interest rate swaps designated as cash flow hedges 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 into 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 $12.2 million will be reclassified as a decrease to CAF income.

During the nine months ended November 30, 2011, we entered into the following interest rate derivatives that were designated as cash flow hedges of interest rate risk:

	Nine Months Ended November 30, 2011		
Product	**Number of Instruments**	**Initial Term**	**Initial Notional Amount** *(in thousands)*
Interest rate swaps	16	46 months	$ 1,935,000

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As of November 30, 2011, we had the following outstanding derivatives that were designated as cash flow hedges:

	$000.000.0.	$000.000.0.	$000.000.0.
		As of November 30, 2011	
Product	Number of Instruments	Remaining Term	Current Notional Amount *(in thousands)*
Interest rate swaps	10	46 months	$ 957,000

Non-designated Hedges. Derivative instruments not designated as accounting hedges, including interest rate swaps and interest rate caps, are not speculative. These instruments are used to limit risk for investors in the warehouse facilities, to minimize the funding costs related to certain securitization vehicles and to mitigate interest rate risk associated with related financial instruments. Changes in the fair value of derivatives not designated as accounting hedges are recorded directly in CAF income.

During the nine months ended November 30, 2011, we entered into the following interest rate derivatives that were not designated as accounting hedges:

	Nine Months Ended November 30, 2011		
Product	Number of Instruments	Initial Term	Initial Notional Amount *(in thousands)*
Interest rate caps [1]	2	53 months	$

[1] *Includes one asset derivative and one liability derivative with offsetting initial notional amounts of $20.1 million.*

As of November 30, 2011, we had the following outstanding derivatives that were not designated as accounting hedges:

	$000.000.0.	$000.000.0.	$000.000.0.
		As of November 30, 2011	
Product	Number of Instruments	Remaining Term	Current Notional Amount *(in thousands)*
Interest rate swaps	4	14 to 21 months	$ 87,801
Interest rate caps [1]	12	21 to 50 months	$

[1] *Includes six asset derivatives and six liability derivatives with offsetting notional amounts of $887.9 million.*

Fair Values of Derivative Instruments on the Consolidated Balance Sheets. The tables below present the fair value of our derivative instruments as well as their classification on the consolidated balance sheets. Additional information on fair value measurements is included in Note 7.

DERIVATIVES DESIGNATED AS ACCOUNTING HEDGES

		As of November 30		As of February 28	
(In thousands)	Location	2011	2010	2011	2010
Asset derivatives:					

Interest rate swaps	Other current assets	$ 530	$	$ 2,105	$
Interest rate swaps	Accounts payable		603		
Liability derivatives:					
Interest rate swaps	Accounts payable	(469)	(274)	(1,093)	
Total		$ 61	$ 329	$ 1,012	$

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DERIVATIVES NOT DESIGNATED AS ACCOUNTING HEDGES

(In thousands)	Location	As of November 30 2011	As of November 30 2010	As of February 28 2011	As of February 28 2010
Asset derivatives:					
Interest rate swaps	Other current assets	$ 526	$ 1,267	$ 1,136	$ 1,279
Interest rate caps	Other current assets	304	700	778	1,999
Liability derivatives:					
Interest rate swaps	Accounts payable	(699)	(3,595)	(2,742)	(7,171)
Interest rate caps	Other current assets	(303)	(700)	(779)	(1,982)
Total		$ (172)	$ (2,328)	$ (1,607)	$ (5,875)

Effect of Derivative Instruments on the Consolidated Statements of Earnings. The tables below present the effect of the company s derivative instruments on the consolidated statements of earnings for the nine months ended November 30, 2011 and 2010.

DERIVATIVES DESIGNATED AS ACCOUNTING HEDGES

(In thousands)	Three Months Ended November 30 2011	Three Months Ended November 30 2010	Nine Months Ended November 30 2011	Nine Months Ended November 30 2010
Interest rate swaps:				
Loss recognized in AOCL (1)	$ 1,244	$ 2,571	$ 18,362	$ 11,059
Loss reclassified from AOCL into CAF Income (1)	$ 2,258	$ 750	$ 4,353	$ 1,049
Loss recognized in CAF Income (2)	$	$	$	