CARMAX INC
Form 10-Q
January 08, 2009

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, 2008

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 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, 2008
Common Stock, par value $0.50	220,399,823

A Table of Contents is included on Page 2 and a separate Exhibit Index is included on Page 42.

CARMAX, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CARMAX, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(Unaudited)
(In thousands except per share data)

	Three Months Ended November 30				Nine Months Ended November 30			
	2008	%(1)	2007	%(1)	2008	%(1)	2007	%(1
ales and operating revenues:								
Jsed vehicle sales	$ 1,168,804	80.3	$ 1,514,302	80.3	$ 4,461,969	81.1	$ 4,909,835	79.8
lew vehicle sales	57,508	4.0	76,999	4.1	217,396	4.0	294,393	4.8
Vholesale vehicle sales	176,956	12.2	234,739	12.5	642,552	11.7	761,173	12.4
ther sales and revenues	52,364	3.6	59,260	3.1	181,532	3.3	189,563	3.1
let sales and operating revenues	1,455,632	100.0	1,885,300	100.0	5,503,449	100.0	6,154,964	100.0
ost of sales	1,256,396	86.3	1,642,417	87.1	4,765,586	86.6	5,339,666	86.8
ross profit	199,236	13.7	242,883	12.9	737,863	13.4	815,298	13.2
arMax Auto Finance (loss) income	(15,360)	(1.1)	16,347	0.9	(12,682)	(0.2)	86,827	1.4
elling, general and administrative xpenses	217,482	14.9	210,508	11.2	685,614	12.5	638,518	10.4
ain on franchise isposition							740	
nterest expense	1,525	0.1	44		5,060	0.1	3,010	
nterest income	735	0.1	285		1,353		908	
Loss) earnings before income taxes	(34,396)	(2.4)	48,963	2.6	35,860	0.7	262,245	4.3
ncome tax (benefit) provision	(12,522)	(0.9)	19,117	1.0	14,170	0.3	102,049	1.7
let (loss) earnings	$ (21,874)	(1.5)	$ 29,846	1.6	$ 21,690	0.4	$ 160,196	2.6
Veighted average common shares:								
asic	217,712		216,301		217,468		215,826	
iluted	217,712		220,558		220,692		220,421	
let (loss) earnings per share:								
asic	$ (0.10)		$ 0.14		$ 0.10		$ 0.74	
iluted	$ (0.10)		$ 0.14		$ 0.10		$ 0.73	

1)Percents are calculated as a percentage of net sales and operating revenues and may not equal totals due to rounding.
ee accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Unaudited)
(In thousands except share data)

	November 30, 2008	February 29, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 138,144	$ 12,965
Accounts receivable, net	45,816	73,228
Auto loan receivables held for sale	20,910	4,984
Retained interest in securitized receivables	314,995	270,761
Inventory	601,506	975,777
Prepaid expenses and other current assets	8,885	19,210
Total current assets	1,130,256	1,356,925
Property and equipment, net	948,106	862,497
Deferred income taxes	89,315	67,066
Other assets	50,505	46,673
TOTAL ASSETS	$ 2,218,182	$ 2,333,161
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 177,144	$ 306,013
Accrued expenses and other current liabilities	70,783	58,054
Accrued income taxes	17,672	7,569
Deferred income taxes	14,926	17,710
Short-term debt	12,073	21,017
Current portion of long-term debt	86,895	79,661
Total current liabilities	379,493	490,024

Long-term debt, excluding current portion	176,683	227,153
Deferred revenue and other liabilities	98,303	127,058
TOTAL LIABILITIES	654,479	844,235
Commitments and contingent liabilities		
Shareholders' equity:		
Common stock, $0.50 par value; 350,000,000 shares authorized;		
220,411,219 and 218,616,069 shares issued and outstanding		
as of November 30, 2008, and February 29, 2008, respectively	110,206	109,308
Capital in excess of par value	677,564	641,766
Accumulated other comprehensive loss	(337)	(16,728)
Retained earnings	776,270	754,580
TOTAL SHAREHOLDERS' EQUITY	1,563,703	1,488,926
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 2,218,182	$ 2,333,161

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended November 30	
	2008	2007
Operating Activities:		
Net earnings	$ 21,690	$ 160,196
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	41,379	34,168
Share-based compensation expense	27,038	25,856
Loss on disposition of assets	8,263	35
Deferred income tax benefit	(34,604)	(3,332)
Net decrease (increase) in:		
Accounts receivable, net	27,412	18,644
Auto loan receivables held for sale, net	(15,926)	1,462
Retained interest in securitized receivables	(44,234)	(31,360)
Inventory	374,271	(56,112)
Prepaid expenses and other current assets	10,317	(5,430)
Other assets	177	1,030
Net (decrease) increase in:		
Accounts payable, accrued expenses and other current liabilities and accrued income taxes	(104,495)	(11,881)
Deferred revenue and other liabilities	(4,660)	25,641
Net cash provided by operating activities	306,628	158,917
Investing Activities:		
Capital expenditures	(163,964)	(192,440)
Proceeds from sales of assets	28,355	1,457
(Purchases) sales of money market securities, net	(4,009)	5,000
Purchases of investments available-for-sale	–	(10,000)
Net cash used in investing activities	(139,618)	(195,983)
Financing Activities:		
Decrease in short-term debt, net	(8,944)	(153)
Issuances of long-term debt	487,800	692,200
Payments on long-term debt	(531,036)	(685,011)
Equity issuances, net	9,962	13,157
Excess tax benefits from share-based payment arrangements	387	5,798
Net cash (used in) provided by financing activities	(41,831)	25,991
Increase (decrease) in cash and cash equivalents	125,179	(11,075)
	12,965	19,455

Cash and cash equivalents at beginning of year		
Cash and cash equivalents at end of period	$ 138,144	$ 8,380

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 retai 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. We also sell new vehicles under various franchise agreements at select locations. 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 lenders; the sale of extended service plans 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. The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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. Amounts and percentages in tables may not total due to rounding. Certain previously reported amounts have been reclassified to conform to the current period presentation.

These consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles 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 29, 2008.

Cash and Cash Equivalents. Cash equivalents of $125.3 million as of November 30, 2008, and $2.0 million as of February 29, 2008, consisted of highly liquid investments with original maturities of three months or less.

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3. CarMax Auto Finance (Loss) Income

(In millions)	Three Months Ended November 30 2008	Three Months Ended November 30 2007	Nine Months Ended November 30 2008	Nine Months Ended November 30 2007
Gain on sales of loans originated and sold (1)	$ 11.3	$ 20.9	$ 32.5	$ 57.8
Other (losses) gains (1)	(39.8)	(14.8)	(82.6)	1.0
Total (loss) gain	(28.5)	6.1	(50.1)	58.8
Other CAF income:				
Servicing fee income	10.4	9.5	31.1	27.6
Interest income	12.6	9.1	34.8	24.7
Total other CAF income	23.0	18.7	65.9	52.4
Direct CAF expenses:				
CAF payroll and fringe benefit expense	4.8	4.1	14.0	11.5
Other direct CAF expenses	5.1	4.3	14.5	12.8
Total direct CAF expenses	9.9	8.4	28.4	24.4
CarMax Auto Finance (loss) income	$ (15.4)	$ 16.3	$ (12.7)	$ 86.8

(1)To the extent we recognize valuation or other adjustments related to loans originated in previous quarters of the same fiscal year, the sum of amounts reported for the individual quarters may not equal the year-to-date total.

CAF provides financing for qualified customers at competitive market rates of interest. Throughout each month, we sell substantially all of the loans originated by CAF in securitization transactions as discussed in Note 4. The majority of CAF income has typically been generated by the spread between the interest rates charged to customers and the related cost of funds. A gain, recorded at the time of securitization, results from recording a receivable approximately equal to the present value of the expected residual cash flows generated by the securitized receivables. The cash flows are calculated taking into account expected prepayments, losses and funding costs.

The gain on sales of loans originated and sold includes both the gain income recorded at the time of securitization and the effect of any subsequent changes in valuation assumptions or funding costs that are incurred in the same fiscal period that the loans were originated. Other losses or gains include the effects of changes in valuation assumptions or funding costs related to loans originated and sold during previous fiscal periods. In addition, other losses or gains could include the effects of new securitizations, changes in the valuation of retained subordinated bonds and the resale of receivables in existing securitizations, as applicable.

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 benefit 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. Securitizations

We use a securitization program to fund substantially all of the auto loan receivables originated by CAF. We sell the auto loan receivables to a wholly owned, bankruptcy-remote, special purpose entity that transfers an undivided interest

in the receivables to a group of third-party investors. The investors issue commercial paper supported by the transferred receivables, and the proceeds from the sale of the commercial paper are used to pay for the securitized receivables. This program is referred to as the warehouse facility. The return requirements of investors in asset-backed commercial paper may fluctuate significantly depending on market conditions. In addition, the warehouse facility renews on an annual basis. At renewal both the cost and structure of the facility could change. These changes could have a significant impact on our funding costs.

Historically, we have used term securitizations to refinance the receivables previously securitized through the warehouse facility. 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 securities are used to pay for the securitized receivables. Depending on the transaction structure and market conditions, refinancing receivables in a term securitization could have a significant impact on our results of operations. The impact of refinancing activity will depend upon the securitization structure and market conditions at the refinancing date.

The special purpose entity and investors have no recourse to our assets. Our credit risk is limited to the retained interest. All transfers of receivables are accounted for as sales. When the receivables are securitized, we recognize a gain or loss on the sale of the receivables as described in Note 3.

	Three Months Ended November 30		Nine Months Ended November 30	
(In millions)	2008	2007	2008	2007
Net loans originated	$ 396.8	$ 575.9	$ 1,576.3	$ 1,839.0
Total loans sold	$ 407.0	$ 575.6	$ 1,608.8	$ 1,891.2
Total (loss) gain	$ (28.5)	$ 6.1	$ (50.1)	$ 58.8
Total (loss) gain as a percentage of total loans sold	(7.0)%	1.1%	(3.1)%	3.1%

Retained Interest. We retain an interest in the auto loan receivables that we securitize. The retained interest includes 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 described below. As of November 30, 2008, on a combined basis, the reserve accounts and required excess receivables were 3.9% of managed receivables. The interest-only strip receivables, reserve accounts and required excess receivables serve as a credit enhancement for the benefit of the investors in the securitized receivables.

The fair value of the retained interest was $315.0 million as of November 30, 2008, and $270.8 million as of February 29, 2008. Additional information on fair value measurements is included in Note 6. The receivables underlying the retained interest had a weighted average life of 1.5 years as of November 30, 2008, and February 29, 2008. The weighted average life in periods (for example, months or years) of prepayable assets is calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products and dividing the sum by the initial principal balance.

Interest-only strip receivables. Interest-only strip receivables represent the present value of residual cash flows we expect to receive over the life of the securitized receivables. The value of these receivables is determined by estimating the future cash flows using our assumptions of key factors, such as finance charge income, loss rates, prepayment rates, funding costs and discount rates appropriate for the type of asset and risk. The value of interest-only strip receivables may be affected by external factors, such as changes in the behavior patterns of customers, changes in the strength of the economy and developments in the interest rate markets; therefore, actual performance may differ from these assumptions. We evaluate the performance of the receivables relative to these assumptions on a regular basis. Any financial impact resulting from a change in performance is recognized in earnings in the period in which it occurs.

Reserve accounts. We are required to fund various reserve accounts established 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. In general, each of our securitizations requires that an amount equal to a specified percentage of the original balance of the securitized receivables be deposited in a reserve account on the closing date and that any excess cash generated by the receivables be used to fund the reserve account to the extent necessary to maintain the required

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amount. If the amount on deposit in the reserve account exceeds the required amount, the excess is released through the special purpose entity to the company. In the term securitizations, the amount required to be on deposit in the reserve account must equal or exceed a specified floor amount. The reserve account remains funded until the investors are paid in full, at which time the remaining balance is released through the special purpose entity to the company. The amount on deposit in reserve accounts was $41.0 million as of November 30, 2008, and $37.0 million as of February 29, 2008.

Required excess receivables. The total value of the securitized receivables must exceed the principal amount owed to the investors by a specified amount. The required excess receivables balance represents this specified amount. Any cash flows generated by the required excess receivables are used, if needed, to make payments to the investors. Any remaining cash flows from the required excess receivables are released through the special purpose entity to the company. The unpaid principal balance related to the required excess receivables was $117.1 million as of November 30, 2008, and $63.0 million as of February 29, 2008.

Retained subordinated bonds. In fiscal 2009 and 2008, we retained subordinated bonds issued by securitization trusts. We receive interest payments on the bonds. The bonds are carried at fair value and changes in fair value are included in earnings as a component of CAF income. We base our valuation on observable market prices of the same or similar instruments when available; however, observable market prices are not currently available for these assets due to illiquidity in the credit markets. Our current valuations are primarily based on an average of three non-binding, current market spread quotes from third-party investment banks. By applying these average spreads to current bond benchmarks, as determined through the use of a widely accepted third-party bond pricing model, we have measured a current fair value. The value of retained subordinated bonds was $86.6 million as of November 30, 2008, and $43.1 million as of February 29, 2008.

Key Assumptions Used in Measuring the Fair Value of the Retained Interest and Sensitivity Analysis. The following table shows the key economic assumptions used in measuring the fair value of the retained interest as of November 30, 2008, and a sensitivity analysis showing the hypothetical effect on the retained interest if there were unfavorable variations from the assumptions used. These sensitivity analyses are hypothetical and should be used with caution. In this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in actual circumstances, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

KEY ASSUMPTIONS

(In millions)	Assumptions Used	Impact on Fair Value of 10% Adverse Change	Impact on Fair Value of 20% Adverse Change
Prepayment rate	1.37% - 1.50%	$ 8.2	$ 15.3
Cumulative loss rate	1.39% - 3.90%	$ 10.8	$ 21.6
Annual discount rate	19.00%	$ 5.3	$ 10.4
Warehouse facility costs (1)	2.05%	$ 2.9	$ 5.8

(1)Expressed as a spread above appropriate benchmark rates. Applies only to retained interest in receivables securitized through the warehouse facility. As of November 30, 2008, there were receivables of $907.0 million in the warehouse facility.

Prepayment rate. We use the Absolute Prepayment Model or "ABS" to estimate prepayments. This model assumes a rate of prepayment each month relative to the original number of receivables in a pool of receivables. ABS further assumes that all the receivables are the same size and amortize at the same rate and that each receivable in each month of its life will either be paid as scheduled or prepaid in full. For example, in a pool of receivables originally containing 10,000 receivables, a 1% ABS rate means that 100 receivables prepay each month.

Cumulative loss rate. The cumulative loss rate, or "static pool" net losses, is calculated by dividing the total projected credit losses of a pool of receivables by the original pool balance. Projected credit losses are estimated using the losses experienced to date, the credit quality of the receivables, economic factors and the performance history of similar receivables.

Annual discount rate. The discount rate is the interest rate used for computing the present value of future cash flows and is determined based on the perceived market risk of the underlying auto loan receivables and current market conditions.

Warehouse facility costs. While receivables are securitized in the warehouse facility, our retained interest is exposed to changes in credit spreads and other variable funding costs. The warehouse facility costs are expressed as a spread above appropriate benchmark rates.

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. We are at risk for the retained interest in the securitized receivables and, if the securitized receivables do not perform as originally projected, the value of the retained interest would be impacted.

PAST DUE ACCOUNT INFORMATION

	As of November 30		As of February 29 or 28	
(In millions)	2008	2007	2008	2007
Accounts 31+ days past due	$ 136.1	$ 93.0	$ 86.1	$ 56.9
Ending managed receivables	$ 4,027.3	$ 3,702.6	$ 3,838.5	$ 3,311.0
Past due accounts as a percentage of ending managed receivables	3.38%	2.51%	2.24%	1.72%

CREDIT LOSS INFORMATION

	Three Months Ended November 30		Nine Months Ended November 30	
(In millions)	2008	2007	2008	2007
Net credit losses on managed receivables	$ 21.6	$ 10.3	$ 48.5	$ 25.1
Average managed receivables	$ 4,076.3	$ 3,683.9	$ 4,019.0	$ 3,548.6
Annualized net credit losses as a percentage of average managed receivables	2.11%	1.12%	1.61%	0.94%
Recovery rate	42.4%	50.0%	44.4%	51.3%

SELECTED CASH FLOWS FROM SECURITIZED RECEIVABLES

	Three Months Ended November 30		Nine Months Ended November 30	
(In millions)	2008	2007	2008	2007
Proceeds from new securitizations	$ 307.0	$ 469.0	$ 1,314.8	$ 1,500.5
Proceeds from collections	$ 176.7	$ 247.7	$ 664.9	$ 840.8
Servicing fees received	$ 10.5	$ 9.5	$ 30.9	$ 27.3

Other cash flows received from the retained interest:								
Interest-only strip receivables	$	16.3	$	25.2	$	72.7	$	72.6
Reserve account releases	$	0.1	$	0.3	$	3.2	$	6.1

Proceeds from new securitizations. Proceeds from new securitizations include proceeds from receivables that are newly securitized in or refinanced through the warehouse facility during the indicated period. Balances previously outstanding in term securitizations that were refinanced through the warehouse facility totaled $48.4 million in the first nine months of fiscal 2009 and $50.7 million in the first nine months of fiscal 2008. Proceeds received when we refinance receivables from the warehouse facility are excluded from this table as they are not considered new securitizations.

Proceeds from collections. Proceeds from collections represent principal amounts collected on receivables securitized through the warehouse facility that are used to fund new originations.

Servicing fees. Servicing fees received represent cash fees paid to us to service the securitized receivables.

Other cash flows received from the retained interest. Other cash flows received from the retained interest represents cash that we receive from the securitized receivables other than servicing fees. It includes cash collected on interest-only strip receivables and amounts released to us from reserve accounts.

Financial Covenants and Performance Triggers. The securitization agreement related to the warehouse facility includes various financial covenants and performance triggers. This agreement requires us to meet financial covenants related to a maximum total liabilities to tangible net worth ratio and a minimum fixed charge coverage ratio. Performance triggers require that the pool of securitized receivables in the warehouse facility achieve specified thresholds related to portfolio yield, loss rate and delinquency rate. If these financial covenants and/or thresholds are not met, we could be unable to continue to securitize receivables through the warehouse facility. In addition, the warehouse facility investors could have us replaced as servicer and charge us a higher rate of interest. Further, we could be forced to deposit collections on the securitized receivables with the warehouse agent on a daily basis, deliver executed lockbox agreements to the warehouse facility agent and obtain a replacement counterparty for the interest rate cap agreement related to the warehouse facility. As of November 30, 2008, we were in compliance with the financial covenants and the securitized receivables were in compliance with the performance triggers.

5. Financial Derivatives

We utilize interest rate swaps relating to our auto loan receivable securitizations and our investment in retained subordinated bonds. Swaps are used to better match funding costs to the interest on the fixed-rate receivables being securitized and the retained subordinated bonds and to minimize the funding costs related to certain of our securitizations trusts. During the third quarter of fiscal 2009, we entered into 14 interest rate swaps with initial notional amounts totaling $348.5 million and terms of 41 months. The notional amounts of outstanding swaps totaled $1,033.9 million as of November 30, 2008, and $898.7 million as of February 29, 2008. The fair value of swaps included in accounts payable totaled a liability of $23.4 million as of November 30, 2008, and $15.1 million as of February 29, 2008. Additional information on fair value measurements is included in Note 6.

The market and credit risks associated with interest rate swaps are similar to those relating to other types of financial instruments. Market risk is the exposure created by potential fluctuations in interest rates. We do not anticipate significant market risk from swaps 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.

6. Fair Value Measurements

We adopted Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"), on March 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 defines "fair value" 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 in accordance with SFAS 157 and as disclosed in the tables below. 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 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.

Retained interest in securitized receivables. We retain an interest in the auto loan receivables that we securitize, including interest-only strip receivables, various reserve accounts, required excess receivables and retained subordinated bonds. Excluding the retained subordinated bonds, we estimate the fair value of the retained interest using internal valuation models. These models include a combination of market inputs and our own assumptions as described in Note 4. As the valuation models include significant unobservable inputs, we classified the retained interest as Level 3.

For the retained subordinated bonds, we base our valuation on observable market prices for similar assets when available. Otherwise, our valuations are based on input from independent third parties and internal valuation models, as described in Note 4. As the key assumption used in the valuation is currently based on unobservable inputs, we classified the retained subordinated bonds as Level 3.

Financial derivatives. Financial derivatives are included in either prepaid expenses and other current assets or accounts payable. As part of our risk management strategy, we utilize interest rate swaps relating to our auto loan receivable securitizations and our investment in retained subordinated bonds. Swaps are used to better match funding costs to the interest on the fixed-rate receivables being securitized and the retained subordinated bonds and to minimize the funding costs related to certain of our securitization trusts. 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 swap counterparties. We validate these quotes using our own internal model. Both our internal model and quotes received from bank

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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. Because model inputs can typically be observed in the liquid market and the models do not require significant judgment, these 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

	As of November 30, 2008			
(In millions)	Level 1	Level 2	Level 3	Total
ASSETS				
Money market securities	$ 153.8	$ –	$ –	$ 153.8
Retained interest in securitized receivables	–	–	315.0	315.0
Total assets at fair value	$ 153.8	$ –	$ 315.0	$ 468.8
Percent of total assets at fair value	32.8%	–%	67.2%	100.0%
Percent of total assets	6.9%	–%	14.2%	21.1%
LIABILITIES				
Financial derivatives	$ –	$ 23.4	$ –	$ 23.4
Total liabilities at fair value	$ –	$ 23.4	$ –	$ 23.4
Percent of total liabilities	–%	3.6%	–%	3.6%

CHANGES IN THE LEVEL 3 ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS

(In millions)	Retained interest in securitized receivables
Balance as of March 1, 2008	$ 270.8
Total realized/unrealized losses (1)	(54.1)
Purchases, sales, issuances and settlements	98.3
Balance as of November 30, 2008	$ 315.0
Change in unrealized losses on assets still held (1)	$ (41.2)

(1)Reported in CarMax Auto Finance (loss) income on the consolidated statements of operations.

7. Income Taxes

We had $27.8 million of gross unrecognized tax benefits as of November 30, 2008, and $32.7 million as of February 29, 2008. During the first nine months of fiscal 2009, we settled federal and state liabilities of $7.8 million related to the Internal Revenue Service audit of fiscal years 2003 and 2004. For the nine-month period ended November 30, 2008, there were no other significant changes to the unrecognized tax benefits as reported for the year ended February 29, 2008, as all other activity was related to positions taken on tax returns filed or intended to be filed in the current fiscal year.

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8. Retirement Plans

We have a noncontributory defined benefit pension plan (the "pension plan") covering the majority of full-time employees. We also have an unfunded nonqualified plan (the "restoration plan") that restores retirement benefits for certain senior executives who are affected by Internal Revenue Code limitations on benefits provided under the pension plan. We use a fiscal year end measurement date for both the pension plan and the restoration plan.

COMPONENTS OF NET PENSION EXPENSE

	Three Months Ended November 30					
	Pension Plan		Restoration Plan		Total	
(In thousands)	2008	2007	2008	2007	2008	2007
Service cost	$ 2,368	$ 3,918	$ 203	$ 222	$ 2,571	$ 4,140
Interest cost	1,526	1,499	177	147	1,703	1,646
Expected return on plan assets	(1,408)	(999)	–	–	(1,408)	(999)
Amortization of prior service cost	5	9	14	78	19	87
Recognized actuarial (gain) loss	(463)	743	49	37	(414)	780
Pension expense	2,028	5,170	443	484	2,471	5,654
Curtailment (gain) loss	(8,229)	–	800	–	(7,429)	–
Net pension (benefit) expense	$ (6,201)	$ 5,170	$ 1,243	$ 484	$ (4,958)	$ 5,654

	Nine Months Ended November 30					
	Pension Plan		Restoration Plan		Total	
(In thousands)	2008	2007	2008	2007	2008	2007
Service cost	$ 9,252	$ 11,754	$ 631	$ 516	$ 9,883	$ 12,270
Interest cost	5,056	4,497	593	351	5,649	4,848
Expected return on plan assets	(4,098)	(2,997)	–	–	(4,098)	(2,997)
Amortization of prior service cost	23	27	74	90	97	117
Recognized actuarial (gain) loss	(175)	2,229	247	129	72	2,358
Pension expense	10,058	15,510	1,545	1,086	11,603	16,596
Curtailment (gain) loss	(8,229)	–	800	–	(7,429)	–
Net pension expense	$ 1,829	$ 15,510	$ 2,345	$ 1,086	$ 4,174	$ 16,596

We made contributions to the pension plan totaling $15.6 million during the first nine months of fiscal 2009. We do not anticipate making a contribution to the pension plan in the fourth quarter of fiscal 2009.

On October 21, 2008, the board of directors approved amendments to freeze the pension plan and the restoration plan effective December 31, 2008. No additional benefits will accrue under these plans after that date. On January 1, 2009, we will implement significant enhancements to our 401(k) plan, including both an increased matching component and a company-funded contribution made regardless of associate participation, and a new non-qualified retirement plan for

certain senior executives who are affected by Internal Revenue Code limitations on benefits provided under the 401(k) plan.

9. Debt

Our revolving credit facility expires in December 2011 and is secured by vehicle inventory. Borrowings under this credit facility are subject to limitation based on a specified percentage of qualifying inventory, and they are available for working capital and general corporate purposes. As of November 30, 2008, $248.4 million was outstanding under the credit facility and $225.4 million of the remaining borrowing limit was available to us. The outstanding balance included $12.1 million

classified as short-term debt, $86.3 million classified as current portion of long-term debt and $150.0 million classified as long-term debt. We classified $86.3 million of the outstanding balance as of November 30, 2008, as current portion of long-term debt based on our expectation that this balance will not remain outstanding for more than one year.

Obligations under capital leases as of November 30, 2008, consisted of $0.6 million classified as current portion of long-term debt and $26.7 million classified as long-term debt.

10. Share-Based Compensation

We maintain long-term incentive plans for management, key employees and the non-employee members of our board of directors. The plans allow for the grant of equity-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock awards, stock grants or a combination of awards. To date, we have awarded no incentive stock options.

Stock options are awards that allow the recipient to purchase shares of our stock at a fixed price. Stock options are granted at an exercise price equal to the volume-weighted average fair market value of our stock on the grant date. Substantially all of the stock options vest annually in equal amounts over periods of three to four years. These options expire no later than ten years after the date of the grant. Restricted stock awards are subject to specified restrictions and a risk of forfeiture. The restrictions typically lapse three years from the grant date.

COMPOSITION OF SHARE-BASED COMPENSATION EXPENSE

	Three Months Ended November 30		Nine Months Ended November 30	
(In thousands)	2008	2007	2008	2007
Cost of sales	$ 582	$ 500	$ 1,585	$ 1,425
CarMax Auto Finance income	355	299	784	896
Selling, general and administrative expenses	7,227	7,565	25,494	24,441
Share-based compensation expense, before income taxes	$ 8,164	$ 8,364	$ 27,863	$ 26,762

We measure share-based compensation expense at the grant date, based on the estimated fair value of the award and the number of awards expected to vest. We recognize compensation expense for stock options and restricted stock on a straight-line basis (net of estimated forfeitures) over the requisite service period, which is generally the vesting period of the award. Our employee stock purchase plan is considered a liability-classified compensatory plan; the associated costs of $0.8 million in the first nine months of fiscal 2009 and $0.9 million in the first nine months of 2008 are included in share-based compensation expense. There were no capitalized share-based compensation costs as of November 30, 2008 and 2007.

STOCK OPTION ACTIVITY

(Shares and intrinsic value in thousands)	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding as of March 1, 2008	13,648	$ 14.55		
Options granted	2,220	$ 19.56		
Options exercised	(788)	$ 12.67		

Options forfeited or expired	(146)	$	16.79			
Outstanding as of November 30, 2008	14,934	$	15.38	5.2	$	1,017
Exercisable as of November 30, 2008	9,509	$	13.14	4.8	$	1,017

For the nine months ended November 30, 2008 and 2007, we granted nonqualified options to purchase 2,219,857 and 1,775,478 shares of common stock, respectively. The total cash received as a result of stock option exercises was $10.0 million in the first nine months of fiscal 2009 and $13.2 million in the first nine months of fiscal 2008. We settle stock option exercises with authorized but unissued shares of CarMax common stock. The total intrinsic value of options exercised was $5.6 million for the first nine months of fiscal 2009 and $22.0 million for the first nine months of fiscal 2008. We realized related tax benefits of $2.2 million in the first nine months of fiscal 2009 and $8.7 million in the first nine months of fiscal 2008.

OUTSTANDING STOCK OPTIONS

As of November 30, 2008 (Shares in thousands)	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 6.62 to $ 9.30	2,197	4.2	$ 7.16	2,197	$ 7.16
$ 10.74 to $13.42	4,228	5.1	$ 13.21	3,272	$ 13.21
$ 14.13 to $15.72	2,847	5.3	$ 14.71	2,729	$ 14.70
$ 16.33 to $22.29	3,980	5.5	$ 18.61	884	$ 17.14
$ 24.99 to $25.79	1,682	5.4	$ 25.04	427	$ 25.05
Total	14,934	5.2	$ 15.38	9,509	$ 13.14

For all stock options granted prior to March 1, 2006, the fair value was estimated as of the date of grant using a Black-Scholes option-pricing model. For stock options granted to employees on or after March 1, 2006, 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 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 the Black-Scholes model. For grants to nonemployee directors prior to fiscal 2009, we used the Black-Scholes model to estimate the fair value of stock option awards. Beginning in fiscal 2009, we used the binomial 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 values at the date of grant for options granted during the nine-month periods ended November 30, 2008 and 2007, was $7.16 and $8.58 per share, respectively. The unrecognized compensation costs related to nonvested options totaled $23.1 million as of November 30, 2008. These costs are expected to be recognized over a weighted average period of 2.2 years.

ASSUMPTIONS USED TO ESTIMATE OPTION VALUES

Nine Months Ended November 30

	2008	2007
Dividend yield	0.0%	0.0%
Expected volatility factor (1)	34.8% - 60.9%	28.0% - 54.0%
Weighted average expected volatility	44.1%	38.8%
Risk-free interest rate (2)	1.5% - 3.7%	4.6% - 5.0%
Expected term (in years) (3)	4.8 - 5.2	4.2 - 4.4

(1)Measured using historical daily price changes of our stock for a period corresponding to the term of the option 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.

RESTRICTED STOCK ACTIVITY

(In thousands)	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding as of March 1, 2008	1,721	$ 21.04
Restricted stock granted	1,079	$ 19.82
Restricted stock vested or cancelled	(117)	$ 20.87
Outstanding as of November 30, 2008	2,683	$ 20.55

For the nine months ended November 30, 2008 and 2007, we granted 1,078,580 and 903,815 shares of restricted stock, respectively. The fair value of a restricted stock award is determined and fixed based on the volume-weighted average fair market value of our stock on the grant date. The unrecognized compensation costs related to nonvested restricted stock awards totaled $24.0 million as of November 30, 2008. These costs are expected to be recognized over a weighted average period of 1.4 years.

11. Net (Loss) Earnings per Share

BASIC AND DILUTIVE NET (LOSS) EARNINGS PER SHARE RECONCILIATIONS

	Three Months Ended November 30		Nine Months Ended November 30	
(In thousands except per share data)	2008	2007	2008	2007
Net (loss) earnings applicable to common shareholders	$ (21,874)	$ 29,846	$ 21,690	$ 160,196
Weighted average common shares outstanding	217,712	216,301	217,468	215,826
Dilutive potential common shares:				
Stock options	–	3,667	2,210	4,081
Restricted stock	–	590	1,014	513
Weighted average common shares and dilutive potential common shares	217,712	220,558	220,692	220,421
Basic net (loss) earnings per share	$ (0.10)	$ 0.14	$ 0.10	$ 0.74
Diluted net (loss) earnings per share	$ (0.10)	$ 0.14	$ 0.10	$ 0.73

Options to purchase 14,934,460 shares of common stock were outstanding and not included in the calculation of diluted net (loss) earnings per share for the quarter ended November 30, 2008, because their inclusion would be antidilutive. Options to purchase 1,782,493 shares of common stock were outstanding and not included in the calculation for the quarter ended November 30, 2007.

12. Accumulated Other Comprehensive Loss

(In thousands, net of income taxes)	Unrecognized Actuarial Losses	Unrecognized Prior Service Cost	Total Accumulated Other Comprehensive Loss
	$ 15,926	$ 802	$ 16,728

Balance as of February 29, 2008			
Amounts arising during the period	4,512	–	4,512
Amortization expense	(68)	(65)	(133)
Curtailment of retirement plans	(20,033)	(737)	(20,770)
Balance as of November 30, 2008	$ 337	$ –	$ 337

The cumulative balances are net of deferred tax of $0.2 million as of November 30, 2008, and $9.8 million as of February 29, 2008.

13. Contingent Liabilities

On April 2, 2008, Mr. John Fowler filed a putative class action lawsuit against CarMax Auto Superstores California, LLC and CarMax Auto Superstores West Coast, Inc. in the Superior Court of California, County of Los Angeles. Subsequently, two other lawsuits, Leena Areso et al. v. CarMax Auto Superstores California, LLC and Justin Weaver v. CarMax Auto Superstores California, LLC, were consolidated as part of the Fowler case. The allegations in the consolidated case involve: (1) failure to provide meal and rest breaks or compensation in lieu thereof; (2) failure to pay wages of terminated or resigned employees related to meal and rest breaks and overtime; (3) failure to pay overtime; (4) failure to comply with itemized employee wage statement provisions; and (5) unfair competition. The putative class consists of sales consultants, sales managers, and other hourly employees who worked for the company in California from April 2, 2004, to the present. The lawsuit seeks compensatory and special damages, wages, interest, civil and statutory penalties, restitution, injunctive relief and the recovery of attorneys' fees. We are unable to make a reasonable estimate of the amount or range of loss that could result from an unfavorable outcome in this matter.

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

14. Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board ("FASB") issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133" ("SFAS 161"), which expands the disclosure requirements about an entity's derivative instruments and hedging activities. SFAS 161 requires that objectives for using derivative instruments and related hedged activities be disclosed in terms of the underlying risk that the entity is intending to manage and in terms of accounting designation. The fair values of derivative instruments and related hedged activities and their gains are to be disclosed in tabular format showing both the derivative positions existing at period end and the effect of using derivatives during the reporting period. Any credit-risk-related contingent features are to be disclosed and are to include information on the potential effect on an entity's liquidity from using derivatives. Finally, SFAS 161 requires cross-referencing within the notes to enable users of financial statements to better locate information about derivative instruments. These expanded disclosure requirements are required for every annual and interim reporting period for which a balance sheet and statement of operations are presented. SFAS 161 is effective for any reporting period (annual or quarterly interim) beginning after November 15, 2008, with early application encouraged. We will be adopting SFAS 161 effective as of the start of the fourth quarter of fiscal 2009.

In October 2008, the FASB issued FASB Staff Position Financial Accounting Standard 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active," ("FSP FAS 157-3"), which clarifies application of SFAS 157 in a market that is not active. FSP FAS 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued. The adoption of FSP FAS 157-3 had no impact on our results of operations, financial condition or cash flows.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities." This disclosure-only FSP improves the transparency of transfers of financial assets and an enterprise's involvement with variable interest entities, including qualifying special-purpose entities. This FSP is effective for the first reporting period (interim or annual) ending after December 15, 2008, with earlier application encouraged. We will be adopting this FSP effective as of the start of the fourth quarter of fiscal 2009. We do not expect the adoption of the FSP will have any impact on our results of operations, financial condition or cash flows.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS 159") was effective for our fiscal year beginning March 1, 2008. SFAS 159 permits entities to measure certain financial assets and liabilities at fair value. The fair value option may be elected on an instrument-by-instrument basis and is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected are recognized in earnings at each subsequent reporting date. We did not elect to apply the fair value option to any of our financial assets or liabilities not already within the scope of SFAS 157.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations (revised 2007)" ("SFAS 141(R)"). SFAS 141(R) replaces SFAS No. 141, "Business Combinations" ("SFAS 141"), but retains the requirement that the purchase method of accounting for acquisitions be used for all business combinations. SFAS 141(R) expands on the disclosures previously required by SFAS 141, better defines the acquirer and the acquisition date in a business combination and establishes principles for recognizing and measuring the assets acquired (including goodwill), the liabilities assumed and any noncontrolling interests in the acquired business. SFAS 141(R) also requires an acquirer to record an adjustment to income tax expense for changes in valuation allowances or uncertain tax positions related to acquired businesses. SFAS 141(R) is effective for all business combinations with an acquisition date in the first annual period following December 15, 2008; early adoption is not permitted. We will apply the provisions of SFAS 141(R) when applicable.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 requires that noncontrolling (or minority) interests in subsidiaries be reported in the equity section of our balance sheet, rather than in a mezzanine section of the balance sheet between liabilities and equity. SFAS 160 also changes the manner in which the net income of the subsidiary is reported and disclosed in the controlling company's income statement. SFAS 160 also establishes guidelines for accounting for changes in ownership percentages and for deconsolidation. SFAS 160 is effective for financial statements for fiscal years beginning on or after December 1, 2008, and interim periods within those years. As of November 30, 2008, we did not hold any noncontrolling interests in subsidiaries.

In April 2008, the FASB issued FSP FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). In developing assumptions about renewal or extension, FSP FAS 142-3 requires an entity to consider its own historical experience (or, if no experience, market participant assumptions) adjusted for the entity-specific factors in paragraph 11 of SFAS 142. FSP FAS 142-3 expands the disclosure requirements of SFAS 142 and is effective for financial statements issued for fiscal years beginning after December 15, 2008, with early adoption prohibited. The guidance for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. We believe the adoption of FSP FAS 142-3 will have no material impact on our results of operations, financial condition or cash flows.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ("GAAP") in the United States ("the GAAP hierarchy"). SFAS 162 makes the GAAP hierarchy explicitly and directly applicable to preparers of financial statements, a step that recognizes preparers' responsibilities for selecting the accounting principles for their financial statements, and sets the stage for making the framework of FASB Concept Statements fully authoritative. The effective date for SFAS 162 is 60 days following the SEC's approval of the Public Company Accounting Oversight Board's related amendments to remove the GAAP hierarchy from auditing standards, where it has resided for some

time. The adoption of SFAS 162 will have no impact on our results of operations, financial condition or cash flows.

In June 2008, the FASB issued FASB Staff Position Emerging Issues Task Force No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting, and therefore need to be included in the earnings allocation in computing earnings per share under the two-class method as described in SFAS No. 128, "Earnings per Share." Under the guidance of FSP EITF 03-6-1, unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Our restricted stock awards are considered "participating securities" because they contain nonforfeitable rights to dividends. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all prior-period earnings per share data presented shall be adjusted retrospectively. Early application is not permitted. We are currently evaluating the impact of FSP EITF 03-6-1 on our consolidated financial statements and will adopt FSP EITF 03-6-1 effective March 1, 2009.

In September 2008, the FASB issued exposure drafts that eliminate qualifying special purpose entities from the guidance of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," and FASB Interpretation 46 (revised December 2003), "Consolidation of Variable Interest Entities - an interpretation of ARB No. 51," as well as other modifications. While the proposed revised pronouncements have not been finalized and the proposals are subject to further public comment, the changes could have a significant impact on our consolidated financial statements as we could potentially be precluded from using sales accounting treatment for our securitization transactions, which would change the timing of the recognition of CAF income. In addition, the changes could result in the consolidation of the financial assets and liabilities transferred to our qualified special purpose entities. The changes would be effective March 1, 2010, on a prospective basis.

ITEM 2.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is provided as a supplement to, and should be read in conjunction with, our audited consolidated financial statements, the accompanying notes and the MD&A included in our Annual Report on Form 10-K for the fiscal year ended February 29, 2008, as well as our consolidated financial statements and the accompanying notes included in this Form 10-Q.

In this discussion, "we," "our," "us," "CarMax," "CarMax, Inc." and "the company" refer to CarMax, Inc. and its wholly o subsidiaries, unless the context requires otherwise. Amounts and percentages in tables may not total due to rounding. Certain prior year amounts have been reclassified to conform to the current presentation.

BUSINESS OVERVIEW

General

CarMax is the nation's largest retailer of used vehicles. We pioneered the used car superstore concept, opening our first store in 1993. Our strategy is to better serve the auto retailing market by addressing the major sources of customer dissatisfaction with traditional auto retailers and to maximize operating efficiencies through the use of standardized operating procedures and store formats enhanced by sophisticated, proprietary management information systems. As of November 30, 2008, we operated 99 used car superstores in 46 markets, comprised of 34 mid-sized markets, 11 large markets and 1 small market. We define mid-sized markets as those with television viewing populations generally between 600,000 and 2.5 million people. We also operated six new car franchises, all of which were integrated or co-located with our used car superstores. In fiscal 2008, we sold 377,244 used cars, representing 96% of the total 392,729 vehicles we sold at retail.

We believe the CarMax consumer offer is distinctive within the automobile retailing marketplace. Our offer provides customers the opportunity to shop for vehicles the same way they shop for items at other "big box" retailers. Our consumer offer is structured around our four customer benefits: low, no-haggle prices; a broad selection; high quality vehicles; and a customer-friendly sales process. Our website, carmax.com, is a valuable tool for communicating the CarMax consumer offer, a sophisticated search engine and an efficient channel for customers who prefer to conduct their shopping online. We generate revenues, income and cash flows primarily by retailing used vehicles and associated items including vehicle financing, extended service plans ("ESPs") and vehicle repair service.

We also generate revenues, income and cash flows from the sale of vehicles purchased through our appraisal process that do not meet our retail standards. These vehicles are sold through on-site wholesale auctions. Wholesale auctions are generally held on a weekly or bi-weekly basis, and as of November 30, 2008, we conducted auctions at 49 used car superstores. During fiscal 2008, we sold 222,406 wholesale vehicles. On average, the vehicles we wholesale are approximately 10 years old and have more than 100,000 miles. Participation in our wholesale auctions is restricted to licensed automobile dealers, the majority of whom are independent dealers and licensed wholesalers.

CarMax provides financing to qualified retail customers through CarMax Auto Finance ("CAF"), our finance operation, and a number of third-party financing providers. We collect fixed, prenegotiated fees from the majority of the

third-party providers, and we periodically test additional providers. CarMax has no recourse liability for the financing provided by these third parties.

We sell ESPs on behalf of unrelated third parties who are the primary obligors. We have no contractual liability to the customer under these third-party service plans. Extended service plan revenue represents commissions from the unrelated third parties.

We are still at a relatively early stage in the national rollout of our retail concept, and as of November 30, 2008, we had used car superstores located in markets that comprised approximately 45% of the U.S. population. Prior to August 2008, we had planned to open used car superstores at a rate of approximately 15% of our used car superstore base each year. In August 2008, we announced that we would temporarily slow our store growth as a result of the weak economic and sales environment. During the third fiscal quarter conditions further deteriorated, and as a consequence, we decided to temporarily suspend our store growth. The suspension of store growth will both reduce our capital needs and aid profitability in the near term.

Over the long term, we believe the primary driver for earnings growth will be vehicle unit sales growth, both from new stores and from stores included in our comparable store base. We target a dollar range of gross profit per used unit sold. The gross profit dollar target for an individual vehicle is based on a variety of factors, including its anticipated probability of sale and its mileage relative to its age; however, it is not based on the vehicle's selling price.

Fiscal 2009 Third Quarter Highlights

§ We believe the weakness in the economy and the stresses on consumer spending continued to adversely affect industry-wide sales in the automotive retail market in the third quarter.
§ Net sales and operating revenues decreased 23% to $1.46 billion from $1.89 billion in the third quarter of fiscal 2008. We reported a net loss of $21.9 million, or $0.10 per share, compared with net earnings of $29.8 million, or $0.14 per share, in the prior year period.
§ Total used vehicle unit sales decreased 17%, reflecting the combination of a 24% decrease in comparable store used unit sales partially offset by growth in our store base. Wholesale vehicle unit sales decreased 15%, reflecting a decrease in both our appraisal traffic and our appraisal buy rate (defined as the number of appraisal purchases as a percent of vehicles appraised). New vehicle unit sales declined 26%, primarily reflecting the extremely soft new car industry trends.
§ We opened one used car superstore in the third quarter, expanding our presence in an existing market.
§ Our total gross profit decreased by $43.6 million, or 18%, to $199.2 million, primarily because of the significant decline in used and wholesale unit sales. Despite the difficult sales environment, our total gross profit dollars per retail unit was relatively resilient, decreasing only $24 to $2,699 per unit from $2,723 per unit in the prior year's third quarter. We believe our ability to maintain a generally consistent level of gross profit per unit, despite the challenging sales environment and the unprecedented decline in wholesale market prices, was due in large part to the effectiveness of our proprietary inventory management systems and processes and our success in dramatically reducing inventories to align them with sales.
§ CAF reported a pretax loss of $15.4 million compared with income of $16.3 million in the third quarter of fiscal 2008. In both periods, CAF results were reduced by adjustments related to loans originated in previous fiscal periods. The adjustments for the third quarter of fiscal 2009 totaled $39.8 million compared with $14.8 million in the prior year quarter. In addition, CAF's gain on loans originated and sold decreased to $11.3 million from $20.9 million in the third quarter of fiscal 2008. This decline was due to the combination of a decline in CAF's loan origination volume, higher loss and discount rate assumptions and increased credit enhancement requirements in the warehouse facility in fiscal 2009.
§ Selling, general and administrative expenses as a percent of net sales and operating revenues (the "SG&A ratio") increased to 14.9% from 11.2% in the third quarter of fiscal 2008. The increase in the SG&A ratio was the result of the significant declines in comparable store used unit sales and average selling price, partially offset by a reduction in variable costs. The fiscal 2009 third-quarter expenses also included a number of non-recurring items, which in the aggregate reduced results by $0.01 per share.

§ For the first nine months of the fiscal year, net cash provided by operations increased to $306.6 million compared with $158.9 million in fiscal 2008, primarily reflecting a large reduction in used vehicle inventories in fiscal 2009, partially offset by the decrease in net earnings.

CRITICAL ACCOUNTING POLICIES

For a discussion of our critical accounting policies, see "Critical Accounting Policies" in MD&A included in Item 7 of the Annual Report on Form 10-K for the fiscal year ended February 29, 2008. These policies relate to securitization transactions, revenue recognition, income taxes and defined benefit retirement plan obligations.

RESULTS OF OPERATIONS

NET SALES AND OPERATING REVENUES

	Three Months Ended November 30				Nine Months Ended November 30			
(In millions)	2008	%	2007	%	2008	%	2007	%
Used vehicle sales	$ 1,168.8	80.3	$ 1,514.3	80.3	$ 4,462.0	81.1	$ 4,909.8	79.8
New vehicle sales	57.5	4.0	77.0	4.1	217.4	4.0	294.4	4.8
Wholesale vehicle sales	177.0	12.2	234.7	12.5	642.6	11.7	761.2	12.4
Other sales and revenues:								
Extended service plan revenues	25.2	1.7	30.1	1.6	93.5	1.7	97.2	1.6
Service department sales	24.7	1.7	23.2	1.2	75.7	1.4	72.6	1.2
Third-party finance fees, net	2.5	0.2	5.9	0.3	12.3	0.2	19.7	0.3
Total other sales and revenues	52.4	3.6	59.3	3.1	181.5	3.3	189.6	3.1
Total net sales and operating revenues	$ 1,455.6	100.0	$ 1,885.3	100.0	$ 5,503.4	100.0	$ 6,155.0	100.0

RETAIL VEHICLE SALES CHANGES

	Three Months Ended November 30		Nine Months Ended November 30	
	2008	2007	2008	2007
Vehicle units:				
Used vehicles	(17)%	9%	(4)%	11%
New vehicles	(26)%	(29)%	(25)%	(16)%
Total	(17)%	7%	(5)%	10%
Vehicle dollars:				
Used vehicles	(23)%	10%	(9)%	12%
New vehicles	(25)%	(30)%	(26)%	(16)%
Total	(23)%	7%	(10)%	10%

Comparable store used unit sales growth is one of the key drivers of our profitability. A store is included in comparable store retail sales in the store's fourteenth full month of operation.

COMPARABLE STORE RETAIL VEHICLE SALES CHANGES

	Three Months Ended November 30		Nine Months Ended November 30	
	2008	2007	2008	2007
Vehicle units:				
Used vehicles	(24)%	0%	(13)%	3%
New vehicles	(26)%	(20)%	(21)%	(12)%
Total	(25)%	(1)%	(13)%	2%
Vehicle dollars:				
Used vehicles	(30)%	0%	(18)%	4%
New vehicles	(25)%	(21)%	(22)%	(12)%
Total	(30)%	(1)%	(18)%	3%

CHANGE IN USED CAR SUPERSTORE BASE

	Three Months Ended November 30		Nine Months Ended November 30	
	2008	2007	2008	2007
Used car superstores, beginning of period	98	81	89	77
Superstore openings:				
Production superstores		1	4	2
Non-production superstores	1	4	6	7
Total superstore openings	1	5	10	9
Used car superstores, end of period	99	86	99	86

Used Vehicle Sales. Our 23% decrease in used vehicle revenues in the third quarter of fiscal 2009 resulted from the combination of a 17% decrease in unit sales and a 7% decrease in average retail selling price. The decline in unit sales reflected a 24% decrease in comparable store used units, partially offset by sales from newer superstores not yet in the comparable store base. Starting in late May 2008, customer traffic in our stores declined sharply, and the decrease in traffic for the third quarter was slightly greater than the 24% decrease in comparable store used unit sales. Despite the more difficult business environment, the solid execution by our store teams allowed us to improve our conversion rate compared with the prior year's third quarter. Our data for the three-month period ended October 31, 2008, indicated that we modestly gained market share in the late-model used vehicle market. The decrease in the average retail selling price was primarily caused by a significant industry-wide drop in used car prices, which reduced our inventory acquisition costs.

Our 9% decrease in used vehicle revenues in the first nine months of fiscal 2009 resulted from the combination of a 4% decline in unit sales and a 6% decrease in average retail selling price. The unit sales decline reflected a 13% decrease in comparable store used units partially offset by sales from newer superstores not yet in the comparable store base. The decline in comparable store used units was primarily the result of the fall off of customer traffic starting in late May 2008, and the decline in average retail selling price reflected our reduced vehicle acquisition costs.

New Vehicle Sales. Compared with the corresponding prior year periods, new vehicle revenues decreased 25% in the third quarter and 26% in the first nine months of fiscal 2009. The declines were substantially the result of decreases in unit sales, which fell 26% in the third quarter and 25% in the first nine months of the year. New vehicle unit sales reflected the extremely soft new car industry sales trends.

Wholesale Vehicle Sales. Vehicles acquired through the appraisal purchase process that do not meet our retail standards are sold at our on-site wholesale auctions. The 25% decrease in wholesale vehicle revenues in the third

quarter of fiscal 2009 resulted from a 15% decrease in wholesale unit sales

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combined with a 12% decline in average wholesale selling price. The decline in the unit sales reflected a decrease in both our appraisal traffic and our appraisal buy rate. Industry wholesale prices for virtually all vehicle classes fell at an unprecedented rate during the third quarter, reflecting the weak demand environment. The vehicle depreciation rate was approximately three times the historical rate for this period. We believe the significant drop in wholesale market values, combined with the overall slowdown in customer traffic, drove the declines in our appraisal traffic and buy rate. The decline in average wholesale selling price reflected the trends in the general wholesale market for the types of vehicles we sell.

The 16% decrease in wholesale vehicle revenues in the first nine months of fiscal 2009 resulted from a 9% decrease in wholesale unit sales combined with an 8% decline in average wholesale selling price. The factors that contributed to these declines in the third quarter were also the cause of the declines for the first nine months of the year.

Other Sales and Revenues. Other sales and revenues include commissions on the sale of ESPs, service department sales and net third-party finance fees. In the third quarter of fiscal 2009, other sales and revenues decreased 12%. ESP sales declined 16%, similar to the decline in total used unit sales. Service department sales increased 6%. Our service operations technicians conduct both vehicle reconditioning and retail auto service, and the decline in used vehicle sales and inventories and the associated reduction in reconditioning volume enabled the increase in service department sales. Third-party finance fees decreased 58% due to a combination of factors including the reduction in vehicle unit sales, a shift in mix among providers and a change in discount arrangements with certain of the providers that occurred in the second quarter of the current fiscal year. Collectively, the third-party providers financed a larger percentage of our retail unit sales in the third quarter compared with the prior year, as we chose to route more credit applications to these providers. Doing so allowed us to slow the use of capacity in our warehouse facility, while maximizing credit availability for our customers and optimizing sales. The fixed fees paid by our third-party financing providers vary by provider, reflecting their differing levels of credit risk exposure. Providers who purchase the highest risk loans purchase these loans at a discount, which is reflected as an offset to the finance fee revenues received from the other third-party providers.

For the first nine months of the year, other sales and revenues decreased 4%. ESP sales decreased 4%, in line with the decrease in total used unit sales. Service department sales increased 4%. Third-party finance fees decreased 37% as many of the factors that affected the third quarter also affected the net fees received in the first nine months.

Seasonality. Historically, our business has been seasonal. Typically, our superstores experience their strongest traffic and sales in the spring and summer quarters. Sales are typically slowest in the fall quarter, when used vehicles generally experience proportionately more of their annual depreciation. We believe this is partly the result of a decline in customer traffic, as well as discounts on model year closeouts that can pressure pricing for late-model used vehicles. Customer traffic also tends to slow in the fall as the weather changes and as customers shift their spending priorities toward holiday-related expenditures. In fiscal 2009, the traditional seasonal sales patterns were masked by the weakness in the economy and the stresses on consumer spending, which adversely affected industry-wide auto sales.

Supplemental Sales Information.

UNIT SALES

	Three Months Ended November 30		Nine Months Ended November 30	
	2008	2007	2008	2007
Used vehicles	71,426	85,973	267,837	278,841
New vehicles	2,397	3,224	9,212	12,309
Wholesale vehicles	45,139	52,960	156,592	171,150

AVERAGE SELLING PRICES

	Three Months Ended November 30		Nine Months Ended November 30	
	2008	2007	2008	2007
Used vehicles	$ 16,146	$ 17,433	$ 16,472	$ 17,434
New vehicles	$ 23,845	$ 23,751	$ 23,456	$ 23,778
Wholesale vehicles	$ 3,805	$ 4,322	$ 3,987	$ 4,337

RETAIL VEHICLE SALES MIX

	Three Months Ended November 30		Nine Months Ended November 30	
	2008	2007	2008	2007
Vehicle units:				
Used vehicles	97%	96%	97%	96%
New vehicles	3	4	3	4
Total	100%	100%	100%	100%
Vehicle dollars:				
Used vehicles	95%	95%	95%	94%
New vehicles	5	5	5	6
Total	100%	100%	100%	100%

RETAIL STORES

	Estimate Feb. 28, 2009(1)	Nov. 30, 2008(1)	Feb. 29, 2008	Nov. 30, 2007
Production(2)	59	59	56	54
Non-production superstores(2)	41	40	33	32
Total used car superstores	100	99	89	86
Co-located new car stores	3	3	3	3
Total	103	102	92	89

(1)Effective October 1, 2008, we converted the superstore in Tucson, Arizona, from a production to a non-production store.
(2)The Clearwater, Florida, superstore has been reclassified from a production to a non-production superstore.

We opened one superstore during the third quarter of fiscal 2009, expanding our presence in the Charlotte market with a non-production superstore in Hickory, North Carolina.

During the first nine months of the year, we opened ten superstores. In addition to the store opened in the third quarter, we entered Phoenix, Arizona, with both a production and a non-production superstore, Charleston, South Carolina, with a non-production superstore; Huntsville, Alabama, with a production superstore; Colorado Springs, Colorado, with a production superstore; and Tulsa, Oklahoma, with a non-production superstore. We also expanded our presence in San Antonio, Texas, and Los Angeles, California, with non-production superstores and Sacramento, California, with a production superstore.

During the first nine months of fiscal 2009, we also expanded our car-buying center test with openings in Dallas, Texas, and Baltimore, Maryland. We now have a total of five car-buying centers at which we conduct appraisals and purchase, but do not sell, vehicles. We will continue to evaluate the performance of these five test centers before

deciding whether to open additional centers in future years. These test stores are part of our long-term program to increase both appraisal traffic and retail vehicle sourcing self-sufficiency, which is the number of vehicles sold at retail that we purchased from consumers.

As of November 30, 2008, we had a total of six new car franchises. Two franchises are integrated within used car superstores, and the remaining four franchises are operated from three facilities that are co-located with select used car superstores. During the second quarter of fiscal 2008, we sold a Chrysler-Jeep-Dodge franchise.

GROSS PROFIT

	Three Months Ended November 30				Nine Months Ended November 30			
	2008		2007		2008		2007	
	$ per unit (1)	%(2)	$ per unit (1)	%(2)	$ per unit (1)	%(2)	$ per unit (1)	%(2)
Used vehicle gross profit	$ 1,854	11.3	$ 1,886	10.7	$ 1,815	10.9	$ 1,936	11.0
New vehicle gross profit	$ 684	2.9	$ 1,043	4.4	$ 832	3.5	$ 1,040	4.3
Wholesale vehicle gross profit	$ 794	20.2	$ 774	17.5	$ 827	20.2	$ 790	17.8
Other gross profit	$ 397	56.0	$ 408	61.4	$ 414	63.2	$ 438	67.2
Total gross profit	$ 2,699	13.7	$ 2,723	12.9	$ 2,663	13.4	$ 2,800	13.2

(1)Calculated as category gross profit divided by its respective units sold, except the other and total categories, which are divided by total retail units sold.
(2)Calculated as a percentage of its respective sales or revenue.

In the third quarter, total gross profit declined by $43.6 million to $199.2 million versus $242.9 million in the prior year primarily because of the significant decreases in used and wholesale unit sales. For the first nine months of the year, total gross profit declined by $77.4 million to $737.9 million from $815.3 million in the prior year due to the combination of the decrease in unit sales and a reduction in total gross profit per unit of $137 to $2,663 per unit from $2,800 per unit.

Used Vehicle Gross Profit. Third quarter fiscal 2009 used vehicle gross profit decreased by $29.7 million to $132.4 million from $162.2 million in the prior year's third quarter. Despite the difficult sales environment, gross profit per unit was relatively resilient, decreasing by only $32 to $1,854 per unit compared with $1,886 per unit for the prior year period. We believe that our ability to maintain a generally consistent level of gross profit per unit, despite the challenging sales environment and the unprecedented decline in wholesale market prices, was due in large part to the effectiveness of our proprietary inventory management systems and processes. In response to the sharp decline in traffic and sales that began in late May 2008, we rapidly reduced our used car inventories during the following months, which brought them back in line with current sales rates and minimized required pricing markdowns. Compared with inventory levels at stores open as of November 30, 2007, we reduced our used vehicle inventory by more than 18,500 units, or approximately $340 million, as of November 30, 2008. During the third quarter of fiscal 2009, we reduced comparable store used vehicle inventories by approximately 8,300 units, or nearly $140 million.

For the first nine months of fiscal 2009, used vehicle gross profit decreased by $53.7 million to $486.1 million from $539.8 million in the prior year period. On a per unit basis, gross profit declined $121 to $1,815 per unit compared with $1,936 per unit in the first nine months of fiscal 2008. We experienced lower appraisal traffic and a lower buy rate in the first nine months of fiscal 2009, which required us to source a larger percentage of our used vehicles at auction, which adversely affected our gross profit per unit. Vehicles purchased at auction typically generate less profit per unit compared with vehicles purchased directly from consumers. Additionally, wholesale industry prices for mid-sized and large SUVs and trucks declined sharply in the spring and early summer, and this rapid decline in valuation resulted in margin pressure which included supplemental markdowns on this segment of our inventory in the

first half of the fiscal year.

New Vehicle Gross Profit. Compared with the corresponding prior year periods, new vehicle gross profit per unit decreased $359 in the third quarter and $208 in the first nine months of fiscal 2009. The decline in overall consumer demand for new cars pressured profits for many new car retailers, including CarMax. However, the decline in new vehicle per-unit profitability had a relatively modest effect on our total gross profits due to the small percentage of new vehicles in our total sales mix.

Wholesale Vehicle Gross Profit. Compared with the corresponding prior year periods, wholesale vehicle gross profit per unit increased $20 in the third quarter and $37 in the first nine months of fiscal 2009. Throughout the first nine months of fiscal 2009, we continued to experience a strong dealer-to-car ratio at our auctions, with the normal price competition among bidders contributing to the strong wholesale gross profit performance. Our wholesale vehicles are predominantly comprised of older, higher mileage vehicles, and we believe the demand for these types of vehicles remains strong from dealers who specialize in selling to credit-challenged customers. In addition, the frequency of our wholesale auctions and our wholesale inventory turns minimize our depreciation risk on these vehicles.

Other Gross Profit. We have no cost of sales related to either ESP revenues or third-party finance fees, as these represent commissions paid to us by the third-party providers. Compared with the corresponding prior year periods, other gross profit per unit declined $11 in the third quarter and $24 in the first nine months of fiscal 2009. For both periods, the decrease in other gross profit per unit primarily reflected the decline in third-party finance fees.

Impact of Inflation. Historically, inflation has not been a significant contributor to results. Profitability is primarily affected by our ability to achieve targeted unit sales and gross profit dollars per vehicle rather than on average retail prices. However, increases in average vehicle selling prices will benefit CAF income, to the extent the average amount financed also increases, and they will also benefit the SG&A ratio.

In the first nine months of fiscal 2009, the weakness in the economy and the stresses on consumer spending contributed to the industry-wide slowdown in the sale of new and used vehicles and to the unprecedented decline in wholesale market prices for most vehicle classes. These lower wholesale values reduced our vehicle acquisition costs and contributed to the decline in our used and wholesale vehicle average selling price.

CarMax Auto Finance (Loss) Income. CAF provides financing for our used and new car sales. Because the purchase of a vehicle is traditionally reliant on the consumer’s ability to obtain on-the-spot financing, it is important to our business that financing be available to creditworthy customers. While financing can also be obtained from third-party sources, we believe that total reliance on third parties can create unacceptable volatility and business risk. Furthermore, we believe that our processes and systems, the transparency of our pricing and our vehicle quality provide a unique and ideal environment in which to procure high quality auto loans, both for CAF and for the third-party financing providers. Historically, CAF has provided us the opportunity to capture additional profits and cash flows from auto loan receivables while managing our reliance on third-party financing sources.

COMPONENTS OF CAF (LOSS) INCOME

	Three Months Ended November 30				Nine Months Ended November 30			
(In millions)	2008	%	2007	%	2008	%	2007	%
Total (loss) gain (1)	$ (28.5)	(7.0)	$ 6.1	1.1	$ (50.1)	(3.1)	$ 58.8	3.1
Other CAF income: (2)								
Servicing fee income	10.4	1.0	9.5	1.0	31.1	1.0	27.6	1.0
Interest income	12.6	1.2	9.1	1.0	34.8	1.2	24.7	0.9
Total other CAF income	23.0	2.3	18.7	2.0	65.9	2.2	52.4	2.0
Direct CAF expenses: (2)								
CAF payroll and fringe benefit expense	4.8	0.5	4.1	0.4	14.0	0.5	11.5	0.4
Other direct CAF expenses	5.1	0.5	4.3	0.5	14.5	0.5	12.8	0.5
Total direct CAF expenses	9.9	1.0	8.4	0.9	28.4	0.9	24.4	0.9
CAF (loss) income (3)	$ (15.4)	(1.1)	$ 16.3	0.9	$ (12.7)	(0.2)	$ 86.8	1.4
Total loans sold	$ 407.0		$ 575.6		$ 1,608.8		$ 1,891.2	
Average managed receivables	$ 4,076.3		$ 3,683.9		$ 4,019.0		$ 3,548.6	
Ending managed receivables	$ 4,027.3		$ 3,702.6		$ 4,027.3		$ 3,702.6	
Total net sales and operating revenues	$ 1,455.6		$ 1,885.3		$ 5,503.4		$ 6,155.0	

Percent columns indicate:
(1) Percent of total loans sold.
(2) Annualized percent of average managed receivables.
(3) Percent of total net sales and operating revenues.

CAF income or loss 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.

CAF originates auto loans to qualified customers at competitive market rates of interest. The majority of CAF income has typically been generated by the spread between the interest rates charged to customers and the related cost of funds. Substantially all of the loans originated by CAF are sold in securitization transactions. A gain, recorded at the time of securitization, results from recording a receivable approximately equal to the present value of the expected residual cash flows generated by the securitized receivables. Historically, the gain on loans originated and sold as a percent of loans originated and sold (the "gain percentage") has generally been in the range of 3.5% to 4.5%. However, the gain percentage has been substantially below the low end of this range in recent quarters, primarily as a result of the disruption in the global credit markets and the more challenging economic environment, which have increased CAF funding costs and caused us to increase the discount rate and loss rate assumptions that affect the gain recognized on the sale of loans.

(LOSS) GAIN AND LOANS SOLD

	Three Months Ended November 30		Nine Months Ended November 30	
(In millions)	2008	2007	2008	2007
Gain on sales of loans originated and sold (1)	$ 11.3	$ 20.9	$ 32.5	$ 57.8
Other (losses) gains (1)	(39.8)	(14.8)	(82.6)	1.0
Total (loss) gain	$ (28.5)	$ 6.1	$ (50.1)	$ 58.8
Loans originated and sold	$ 407.0	$ 575.6	$ 1,560.4	$ 1,840.5
Receivables repurchased from term securitizations and resold	–	–	48.4	50.7
Total loans sold	$ 407.0	$ 575.6	$ 1,608.8	$ 1,891.2
Gain percentage on loans originated and sold	2.8%	3.6%	2.1%	3.1%
Total (loss) gain as a percentage of total loans sold	(7.0)%	1.1%	(3.1)%	3.1%

(1)To the extent we recognize valuation or other adjustments related to loans originated in previous quarters of the same fiscal year, the sum of amounts reported for the individual quarters may not equal the year-to-date total.

The gain on sales of loans originated and sold includes both the gain income recorded at the time of securitization and the effect of any subsequent changes in valuation assumptions or funding costs that are incurred in the same fiscal period that the loans were originated. Other losses or gains include the effects of changes in valuation assumptions or funding costs related to loans originated and sold during previous fiscal periods. In addition, other losses or gains could include the effects of new securitizations, changes in the valuation of retained subordinated bonds and the resale of receivables in existing securitizations, as applicable.

In the third quarter of fiscal 2009, CAF reported a pretax loss of $15.4 million compared with income of $16.3 million in the prior year's third quarter. In both periods, CAF results were reduced by adjustments related to loans originated in previous fiscal periods. In the third quarter of fiscal 2009, the adjustments totaled $39.8 million and they included:

- A $23.8 million mark-to-market write-down in the carrying value of subordinated bonds that we hold. These bonds, which have a face value of $115 million, were part of three term securitizations completed earlier in calendar year 2008. The size of the write-down reflected the illiquidity in the credit markets, particularly for subordinated asset-backed bonds. This non-cash charge primarily affects the timing of the recognition of CAF earnings. If current conditions continue, this adjustment should result in positive contributions to CAF earnings in future periods.
- $16.0 million for increases in loss rate assumptions, partially offset by favorability in prepayment speeds. We increased the upper end of our cumulative loss rate assumption range to 3.9% from 3.5%.

The adjustments in the third quarter of fiscal 2008 totaled $14.8 million, and they primarily resulted from increases in funding costs for loans originated in prior periods.

For the third quarter, CAF's gain on loans originated and sold declined to $11.3 million compared with $20.9 million in fiscal 2008. This decrease was the result of both a reduction in CAF originations and a decrease in the gain percentage. In fiscal 2009, CAF's loan origination volume was adversely affected by the decreases in our used unit sales and average selling price, as well as a decrease in the percentage of sales financed by CAF. Given the limited activity in the public asset-backed securitization market we elected to slow the use of capacity in our warehouse facility during the second half of the quarter. We accomplished this by allowing our third-party finance providers to increase their share of originations. The gain percentage decreased to 2.8% in the third quarter of fiscal 2009 from 3.6% in the corresponding prior year period primarily due to the use of higher loss and discount rate assumptions and higher credit enhancement levels in the current year.

For the first nine months of the year, CAF reported a pretax loss of $12.7 million in fiscal 2009 compared with income of $86.8 million in fiscal 2008. In both periods, CAF results were affected by adjustments related to loans originated in previous fiscal years. In fiscal 2009, the adjustments reduced CAF earnings by $82.6 million and they included:

- A $31.2 million mark-to-market write-down in the carrying value of the subordinated bonds.
- $27.3 million for increases in loss rate assumptions, partially offset by favorability in prepayment speeds.
- $20.1 million for increases in funding costs related to loans that were originated in prior fiscal years.
- $3.8 million for increasing the discount rate assumption from 17% to 19%.

For the first nine months of fiscal 2008, the adjustments increased CAF earnings by $1.0 million and they primarily related to reductions in funding costs related to loans originated in prior fiscal years.

For the nine-month period, CAF's gain on loans originated and sold declined to $32.5 million in fiscal 2009 compared with $57.8 million in fiscal 2008. The gain percentage for the first nine months of the year decreased to 2.1% in fiscal 2009 from 3.1% in fiscal 2008. Many of the factors that contributed to the decline in CAF's gain on loans originated and sold and the decline in the gain percentage in the third quarter of fiscal 2009 were also factors contributing to the declines in these metrics in the first nine months of the year.

Our term securitizations typically contain an option to repurchase the securitized receivables when the outstanding balance in the pool of auto loan receivables falls below 10% of the original pool balance. In the second quarter of fiscal 2009, we exercised this repurchase option and $48.4 million of previously securitized receivables were resold into the warehouse facility. In the second quarter of fiscal 2008, we exercised this repurchase option and $50.7 million of previously securitized receivables were resold into the warehouse facility. Neither of these transactions had a material effect on total gain income. In future periods, the effects of refinancing, repurchase or resale activity could be favorable or unfavorable, depending on the securitization structure and the market conditions at the transaction date.

The increases in servicing fee income and direct CAF expenses in the third quarter and first nine months of fiscal 2009 were proportionate to the growth in managed receivables. The interest income component of other CAF income increased to an annualized 1.2% of average managed receivables in the third quarter of fiscal 2009 from 1.0% in the prior year quarter, primarily due to the increase in the discount rate assumption used to value the retained interest to 19% from 12%. The use of a higher discount rate reduces the gain recognized at the time the loans are sold, but increases the interest income recognized in subsequent periods. Additionally, in fiscal 2009 interest income included the interest earned on the retained subordinated bonds. Prior to January 2008, we had not retained any subordinated bonds.

PAST DUE ACCOUNT INFORMATION

	As of November 30		As of February 29 or 28	
(In millions)	2008	2007	2008	2007
Loans securitized	$ 3,885.6	$ 3,631.2	$ 3,764.5	$ 3,242.1
Loans held for sale or investment	141.6	71.4	74.0	68.9
Ending managed receivables	$ 4,027.3	$ 3,702.6	$ 3,838.5	$ 3,311.0
Accounts 31+ days past due	$ 136.1	$ 93.0	$ 86.1	$ 56.9
Past due accounts as a percentage of ending managed receivables	3.38%	2.51%	2.24%	1.72%

CREDIT LOSS INFORMATION

	Three Months Ended November 30		Nine Months Ended November 30	
(In millions)	2008	2007	2008	2007
Net credit losses on managed receivables	$ 21.6	$ 10.3	$ 48.5	$ 25.1
Average managed receivables	$ 4,076.3	$ 3,683.9	$ 4,019.0	$ 3,548.6
Annualized net credit losses as a percentage of average managed receivables	2.11%	1.12%	1.61%	0.94%
Recovery rate	42.4%	50.0%	44.4%	51.3%

We are at risk for the performance of the managed securitized receivables to the extent of our retained interest in the receivables. If the managed receivables do not perform in accordance with the assumptions used in determining the fair value of the retained interest, earnings could be affected. Our retained interest in securitized receivables was $315.0 million as of November 30, 2008, compared with $270.8 million as of February 29, 2008, and $233.7 million as of November 30, 2007. Compared with both prior periods, our retained interest increased primarily as a result of our holding the retained subordinated bonds and an increase in the required excess receivables, partially offset by a decrease in the interest-only strip receivables. We retained subordinated bonds in the term securitizations completed in January, May and July 2008.

Compared with the corresponding prior year periods, we experienced increases in both past due accounts as a percentage of ending managed receivables and annualized net credit losses as a percentage of average managed receivables in the third quarter and in the first nine months of fiscal 2009. We believe these increases were primarily the result of the less favorable general economic and industry trends for losses and delinquencies.

We continually strive to refine CAF's origination strategy in order to optimize profitability and sales while managing risk. Historically, we originated pools of loans targeted to have cumulative net loss rates in the range of 2.0% to 2.5%. Receivables originated in calendar years 2003, 2004 and early 2005 experienced loss rates well below both CAF's historical averages and these targeted loss rates. We believe this favorability was due, in part, to the credit scorecard we implemented in late 2002. As it became evident that the scorecard was resulting in lower-than-expected loss rates, CAF gradually expanded its credit offers beginning in late 2004. As a result, receivables originated in late 2005 and periods thereafter have been experiencing higher delinquency and loss rates compared with the receivables originated in these earlier years. While the delinquency and projected loss rates on the more recent originations have trended higher than our initial expectations, we believe this has been primarily a reflection of the worsening economic climate. Consequently, we have increased our cumulative net loss assumptions on several more recent securitizations, and we have continued to incorporate similar economic stress into the projections for our most recent originations. In addition, we have tightened CAF's lending criteria for applicants whose credit profile indicates a higher-than-average risk.

The recovery rate represents the average percentage of the outstanding principal balance we receive when a vehicle is repossessed and liquidated at wholesale auction. Historically, the annual recovery rate has ranged from a low of 42% to a high of 51%, and it is primarily affected by changes in the wholesale market pricing environment.

Selling, General and Administrative Expenses. The SG&A ratio increased to 14.9% in the third quarter of fiscal 2009 compared with 11.2% in the third quarter of the prior year. For the nine months ended November 30, 2008, the SG&A ratio increased to 12.5% compared with 10.4% in the first nine months of the prior year. The increases in the SG&A ratio in fiscal 2009 were mainly the result of the declines in comparable store used unit sales and average selling price. The increases in the SG&A ratio were partially offset by reductions in variable costs. In the current market environment, we continue to reduce variable costs by reducing associate hours and allowing natural attrition to further reduce store staffing. In addition, we have implemented a hiring freeze at the home office and are carefully

monitoring expenses at CAF.

SG&A expenses for the third quarter of fiscal 2009 included a number of non-recurring items, which in the aggregate reduced results by $0.01 per share. These items included approximately $7 million of severance costs related to a reduction in our service operations workforce in October and $6 million of costs for the termination of store site acquisitions resulting from our decision to slow our store growth. These costs were partially offset by a $10 million benefit related to our previously announced decision to freeze our pension plans as of December 31, 2008.

In addition, in the first quarter of fiscal 2009, we accrued costs related to litigation that reduced net earnings by $0.02 per share.

Income Taxes. The effective income tax rate was 36.4% in the third quarter of fiscal 2009 compared with 39.0% in the third quarter of fiscal 2008. For the first nine months of the year, the effective tax rate was 39.5% in fiscal 2009 compared with 38.9% in fiscal 2008. Given the current economic conditions and the related impact on the ability to project future results, we determined that the use of the year-to-date effective tax rate versus the estimated annual effective tax rate as used in prior quarters is a more accurate reflection of the results for the quarter and year to date. The effective tax rate for the quarter and the related tax benefit that was realized on the net loss for the third quarter of fiscal 2009 reflect the impact of this adjustment as well as the impact of other permanent tax differences for the year.

OPERATIONS OUTLOOK

Store Openings and Capital Expenditures. In August 2008, we announced that we would temporarily slow our store growth as a result of the weak economic and sales environment. During the third quarter, conditions further deteriorated and as a consequence we have decided to temporarily suspend our store growth. We plan to open one non-production store, which is currently under construction in the Washington, D.C., market, in either late fiscal 2009 or early fiscal 2010. We have three other stores that are currently under construction in Augusta, Georgia; Cincinnati, Ohio; and Dayton, Ohio. These stores will be completed but they will not be opened until market conditions improve.

We currently estimate gross capital expenditures will total between $175 million and $190 million in fiscal 2009. These expenditures primarily relate to construction costs for the ten stores that were opened in the first nine months of the year and the four stores that are still under construction. We had originally expected gross capital expenditures would total approximately $350 million in fiscal 2009. The reduction in planned capital spending reflects our decision to suspend store growth and the related reduction in land purchases for future store openings.

Fiscal 2009 Comparable Store Sales and Earnings Per Share Expectations. As a result of the unprecedented declines in traffic and sales and the continuing volatility in the asset-backed credit markets, we do not believe we can make a meaningful projection of fiscal 2009 comparable store sales or earnings.

Other Items. As described in Note 8, effective December 31, 2008, we will freeze the pension plan and the restoration plan, and no additional benefits will accrue under these plans after that date. On January 1, 2009, we will implement significant enhancements to our 401(k) plan, and we will establish a new non-qualified retirement plan for certain senior executives who are affected by Internal Revenue Code limitations on benefits provided under the 401(k) plan. We believe our revised retirement program will be easier to understand and give associates more control over their retirement savings while also allowing us to control escalating and unpredictable pension expenses.

FINANCIAL CONDITION

Liquidity and Capital Resources.

Operating Activities. Net cash from operating activities increased to $306.6 million in the first nine months of fiscal 2009 from $158.9 million in the first nine months of fiscal 2008, primarily reflecting the significant decrease in inventory in fiscal 2009 partially offset by the decline in net earnings. We reduced inventory

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by $374.3 million in the first nine months of fiscal 2009 compared with an increase of $56.1 million in the prior-year period. In fiscal 2009, we dramatically reduced our used vehicle inventory levels to bring them in line with the lower sales rate. The fiscal 2009 inventory reduction also reflects the decrease in vehicle acquisition costs for most vehicle categories. The increase in inventories in the first nine months of fiscal 2008 reflected the combination of the additional inventories needed to support the expansion of our store base and the expansion of a test in select stores to determine whether a modest expansion of onsite vehicle inventory, generally in the range of 50 to 100 cars per store, would have a favorable effect on sales.

The aggregate principal amount of outstanding auto loan receivables funded through securitizations, which are discussed in Notes 3 and 4 to our consolidated financial statements, totaled $3.89 billion as of November 30, 2008, and $3.63 billion as of November 30, 2007. During the first nine months of fiscal 2009, we completed two term securitizations of auto loan receivables. In July 2008, we completed a term securitization of $525 million of auto loan receivables, and in May 2008 we completed a term securitization of $750 million of auto loan receivables. We retained a total of $70.3 million face value of subordinated bonds in these two securitizations.

During the second quarter of fiscal 2009, we increased the capacity of the warehouse facility, which expires in July 2009, by $400 million to a total of $1.4 billion. As of November 30, 2008, $907 million of auto loan receivables were securitized through the warehouse facility and unused warehouse capacity totaled $493 million. We intend to enter into new, or renew or expand existing funding arrangements to meet CAF's future funding needs. However, based on conditions in the credit markets, the cost for these arrangements could be materially higher than historical costs and the timing of these transactions could be dictated by market availability rather than our requirements. In addition, we are currently evaluating other alternatives to preserve the sales associated with the CAF origination channel. Given the limited activity in the public asset-backed securitization market, during the latter half of the third quarter of fiscal 2009 we elected to slow the use of capacity in our warehouse facility. We accomplished this by allowing our third-party finance providers to increase their share of originations.

Investing Activities. Net cash used in investing activities was $139.6 million in the first nine months of fiscal 2009, compared with $196.0 million in the first nine months of the prior year. Cash used in investing activities consists almost entirely of capital expenditures, which primarily includes store construction costs and the cost of land acquired for future year store openings. These expenditures will vary from quarter to quarter based on the timing of store openings and land acquisitions. Capital expenditures totaled $164.0 million in the fiscal 2009 period and $192.4 million in the fiscal 2008 period. Our investment in future store sites was lower in fiscal 2009 than in fiscal 2008 as a result of our decision to slow and then to temporarily suspend store growth.

Historically, capital expenditures have been funded with internally generated funds, short- and long-term debt and sale-leaseback transactions. During the third quarter of fiscal 2009, we entered into sale-leaseback agreements having a total sales price of $31.3 million for our two used car superstores in Austin, Texas. We received proceeds of $25.4 million during the third quarter, and we provided short-term financing for the remaining $5.9 million, which we expect to receive in fiscal 2010.

As of November 30, 2008, we owned our home office in Richmond, Virginia, and owned 41 superstores currently in operation, including the superstore subject to the sale-leaseback agreement that we expect to complete in fiscal 2010. In addition, five superstores were accounted for as capital leases.

Financing Activities. In the first nine months of fiscal 2009, net cash used in financing activities was $41.8 million while in the first nine months of fiscal 2008 net cash provided by financing activities was $26.0 million. During the third quarter of fiscal 2009, due to the unprecedented conditions in the credit markets, we felt that it was prudent to maintain a higher-than-normal cash balance. Despite the increase in cash and the decline in our results, during the first nine months of fiscal 2009 we reduced total debt by $52.2 million. During the first nine months of fiscal 2008,

we increased total debt by $7.0 million.

During the second quarter of fiscal 2009, we increased the aggregate borrowing limit under our revolving credit facility by $200 million to a total of $700 million. The credit facility expires in December 2011 and is secured by our vehicle inventory. Borrowings under this credit facility are subject to limitation based on a specified percentage of qualifying inventory, and they are available for working capital and general corporate purposes. As of November 30, 2008, $248.4 million was outstanding under the credit facility and $225.4 million of the remaining balance was available to us. The outstanding balance included $12.1 million classified as short-term debt, $86.3 million classified as current portion of long-term debt and $150.0 million classified as long-term debt. We classified $86.3 million of the outstanding balance as of November 30, 2008, as current portion of long-term debt based on our expectation that this balance will not remain outstanding for more than one year.

We expect that cash generated by operations and proceeds from securitization transactions or other funding arrangements, sale-leaseback transactions and borrowings under existing or expanded credit facilities will be sufficient to fund capital expenditures and working capital for the foreseeable future.

Fair Value Measurements. On March 1, 2008, we adopted Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” ("SFAS 157"). SFAS 157 defines fair value and is applied in any situation where an asset or liability is measured at fair value under existing U.S. generally accepted accounting principles. In accordance with SFAS 157, we reported money market securities, retained interest in securitized receivables and financial derivatives at fair value. As these financial assets were already reported at fair value, the implementation of SFAS 157 did not have a material impact on our results of operations, liquidity or financial condition. See Note 6 for more information on the adoption and application of this standard.

Retained interest in securitized receivables was valued at $315.0 million as of November 30, 2008 and $270.8 million as of February 29, 2008. Included in the retained interest were interest-only strip receivables, various reserve accounts and required excess receivables totaling $228.4 million and $227.7 million as of November 30, 2008, and February 29, 2008, respectively. In addition, the retained interest included retained subordinated bonds totaling $86.6 million and $43.1 million as of November 30, 2008, and February 29, 2008, respectively.

As described in Note 4, we use discounted cash flow models to measure the fair value of retained interest, excluding retained subordinated bonds. In addition to funding costs and prepayment rates, the estimates of future cash flows are based on certain key assumptions, such as loss rates and discount rates appropriate for the type of asset and risk, both of which are significant unobservable inputs. Changes in these inputs could have a material impact on our financial condition or results of operations, as they have had in the past.

In measuring the fair value of the retained subordinated bonds, we use a widely accepted third-party bond pricing model. Our key assumption is determined based on current market spread quotes from third-party investment banks and is currently a significant unobservable input. Changes in this input could have a material impact on our financial condition or results of operations.

During the first nine months of fiscal 2009, changes were made to certain key assumptions used in measuring the fair value of retained interest. For a discussion of the effects of these changes, see the “(Loss) Gain and Loans Sold” section of CarMax Auto Finance Income in MD&A starting on page 30.

As the key assumptions used in measuring the fair value of the retained interest (including the retained subordinated bonds) are significant unobservable inputs, retained interest is classified as a Level 3 asset in accordance with the SFAS 157 hierarchy. Retained interest represents 67.2% of the total assets measured at fair value, as disclosed in Note 6.

FORWARD-LOOKING STATEMENTS

We caution readers that the statements contained in this report about our future business plans, operations, opportunities, or prospects, including without limitation any statements or factors regarding expected sales, margins or earnings, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based upon management's current knowledge and assumptions about future events and involve risks and uncertainties that could cause actual results to differ materially from anticipated results. We disclaim any intent or obligation to update these statements. Among the factors that could cause actual results and outcomes to differ materially from those contained in the forward-looking statements are the following:

- Changes in general U.S. or regional U.S. economic conditions.
- Changes in the availability or cost of capital and working capital financing, including the availability and cost of long-term financing to support our geographic expansion and the availability and cost of financing auto loans receivable.
- Changes in consumer credit availability related to our third-party financing providers.
- Changes in the competitive landscape within our industry.
- Significant changes in retail prices for used and new vehicles.
- A reduction in the availability or access to sources of inventory.
- Factors related to the regulatory environment in which we operate.
- The loss of key employees from our store, region and corporate management teams.
- The failure of key information systems.
- The effect of new accounting requirements or changes to U.S. generally accepted accounting principles.
- Security breaches or other events that result in the misappropriation, loss or other unauthorized disclosure of confidential customer information.
- The effect of various litigation matters.
- Our inability to acquire or lease suitable real estate at favorable terms.
- Adverse conditions affecting one or more domestic-based automotive manufacturers.
- The occurrence of severe weather events.
- Factors related to seasonal fluctuations in our business.
- Factors related to the geographic concentration of our superstores.
- The occurrence of certain other material events.

For more details on factors that could affect expectations, see Part II, Item 1A. "Risk Factors" on page 39 of this report, our Annual Report on Form 10-K for the fiscal year ended February 29, 2008, and our quarterly or current reports as filed with or furnished to the Securities and Exchange Commission. Our filings are publicly available on our investor information home page at investor.carmax.com. Requests for information may also be made to our Investor Relations Department by email to investor_relations@carmax.com or by calling 1-804-747-0422, ext. 4489.

ITEM 3.

QUANTITATIVE AND QUALITATIVE
DISCLOSURES ABOUT MARKET RISK

Auto Loan Receivables. As of November 30, 2008, and February 29, 2008, all loans in our portfolio of auto loan receivables were fixed-rate installment loans. Financing for these auto loan receivables was achieved through asset securitization programs that, in turn, issue both fixed- and floating-rate securities. We manage the interest rate exposure relating to floating-rate securitizations through the use of interest rate swaps. Disruptions in the credit markets could impact the effectiveness of our hedging strategies. Receivables held for investment or sale are financed with working capital. Generally, changes in interest rates associated with underlying swaps will not have a material impact on earnings; however, they could have a material impact on cash and cash flows.

Credit risk is the exposure to nonperformance of another party to an agreement. We mitigate credit risk by dealing with highly rated bank counterparties. The market and credit risks associated with financial derivatives are similar to those relating to other types of financial instruments. Notes 5 and 6 provide additional information on financial derivatives.

COMPOSITION OF AUTO LOAN RECEIVABLES

(In millions)		November 30, 2008		February 29, 2008
Principal amount of:				
Fixed-rate securitizations	$	2,562.4	$	2,533.4
Floating-rate securitizations synthetically altered to fixed (1)		1,323.0		1,230.6
Floating-rate securitizations		0.3		0.5
Loans held for investment (2)		120.7		69.0
Loans held for sale (3)		20.9		5.0
Total	$	4,027.3	$	3,838.5

(1)Includes $416.3 million of variable-rate securities issued in connection with certain term securitizations that were synthetically altered to fixed at the bankruptcy-remote special purpose entity.
(2)The majority is held by a bankruptcy-remote special purpose entity.
(3)Held by a bankruptcy-remote special purpose entity.

Interest Rate Exposure. We also have interest rate risk from changing interest rates related to our outstanding debt. Substantially all of our debt is floating-rate debt based on LIBOR. A 100-basis point increase in market interest rates would have decreased our net earnings per share by less than $0.01 for the three months ended November 30, 2008 and $0.01 for the nine months ended November 30, 2008.

ITEM 4.

CONTROLS AND PROCEDURES

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

As of the end of the period covered by this report, we evaluated the effectiveness of the design and operation of our disclosure controls. This evaluation was performed under the supervision and with the participation of management, including the CEO and CFO. Based upon that evaluation, the CEO and CFO concluded that our disclosure controls were effective as of the end of the period. There was no change in our internal control over financial reporting that occurred during the quarter ended November 30, 2008, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On April 2, 2008, Mr. John Fowler filed a putative class action lawsuit against CarMax Auto Superstores California, LLC and CarMax Auto Superstores West Coast, Inc. in the Superior Court of California, County of Los Angeles. Subsequently, two other lawsuits, Leena Areso et al. v. CarMax Auto Superstores California, LLC and Justin Weaver v. CarMax Auto Superstores California, LLC, were consolidated as part of the Fowler case. The allegations in the consolidated case involve: (1) failure to provide meal and rest breaks or compensation in lieu thereof; (2) failure to pay wages of terminated or resigned employees related to meal and rest breaks and overtime; (3) failure to pay overtime; (4) failure to comply with itemized employee wage statement provisions; and (5) unfair competition. The putative class consists of sales consultants, sales managers, and other hourly employees who worked for the company in California from April 2, 2004 to the present. The lawsuit seeks compensatory and special damages, wages, interest, civil and statutory penalties, restitution, injunctive relief and the recovery of attorneys' fees.

In November 2008, the United States District Court of the Eastern District of Virginia dismissed, without prejudice, the Rangos putative class action lawsuit in response to the plaintiff's voluntary motion to dismiss. This lawsuit was related to alleged violations of federal securities laws.

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

Item 1A. Risk Factors

In connection with information set forth in this Form 10-Q, the factors discussed under "Risk Factors" in our Form 10-K for fiscal year ended February 29, 2008, and in our Form 10-Q for our second fiscal quarter ended August 31, 2008, should be considered. Additionally, we are subject to the risk set forth below:

Domestic-based Automotive Manufacturers. Adverse conditions affecting one or more domestic-based automotive manufacturers may impact our profitability. Recently, the financial condition and operating results of these manufacturers have deteriorated significantly, and it is possible that one or all of these manufacturers could file for bankruptcy protection. Certain actions that these manufacturers may take, including bankruptcy filing, could have a material effect on our business, results of operations and financial condition.

The risks included in the Form 10-K, the second quarter Form 10-Q and as set forth above could materially and adversely affect our business, financial condition, and results of operations.

Other than as set forth above and in the second quarter Form 10-Q, there have been no material changes to the factors discussed in our Form 10-K.

Item 6. Exhibits

4.2 Appointment, Assignment and Assumption Agreement, dated as of November 28, 2008, between CarMax, Inc. and American Stock Transfer & Trust Company, LLC, filed herewith.

10.1 Form of Notice of Stock Option Grant between CarMax, Inc. and certain named and other executive officers, filed herewith. *

10.2 Form of Notice of Restricted Stock Grant between CarMax, Inc. and certain executive officers, filed herewith. *

10.3 Form Amendment to Employment/Severance Agreement between CarMax, Inc. and certain named and other executive officers, filed herewith. *

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

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

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

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

* Indicates management contracts, compensatory plans or arrangements of the company required to be filed as an exhibit.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CARMAX, INC.

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

By: /s/ Keith D. Browning
Keith D. Browning
Executive Vice President and
Chief Financial Officer

January 8, 2009

EXHIBIT INDEX

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