CARMAX INC
Form 10-Q
January 07, 2016

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, 2015

OR

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

Commission File Number: 1-31420

CARMAX, INC.
(Exact name of registrant as specified in its charter)

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

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

(804) 747-0422
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

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

Class	Outstanding as of December 31, 2015
Common Stock, par value $0.50	195,729,323

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CARMAX, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CARMAX, INC. AND SUBSIDIARIES
Consolidated Statements of Earnings
(Unaudited)

	Three Months Ended November 30				Nine Months Ended November 30			
(In thousands except per share data)	2015	%[1]	2014	%[1]	2015	%[1]	2014	%[1]
SALES AND OPERATING REVENUES:								
Used vehicle sales	$2,908,963	82.1	$2,794,515	82.1	$9,351,841	81.7	$8,775,021	81.6
New vehicle sales	42,291	1.2	54,561	1.6	162,832	1.4	194,294	1.8
Wholesale vehicle sales	513,796	14.5	481,676	14.1	1,682,195	14.7	1,557,191	14.5
Other sales and revenues	79,019	2.2	74,482	2.2	247,002	2.2	228,118	2.1
NET SALES AND OPERATING REVENUES	3,544,069	100.0	3,405,234	100.0	11,443,870	100.0	10,754,624	100.0
Cost of sales	3,079,738	86.9	2,958,614	86.9	9,914,375	86.6	9,342,934	86.9
GROSS PROFIT	464,331	13.1	446,620	13.1	1,529,495	13.4	1,411,690	13.1
CARMAX AUTO FINANCE INCOME	92,316	2.6	89,722	2.6	299,703	2.6	276,911	2.6
Selling, general and administrative expenses	337,512	9.5	316,632	9.3	1,018,075	8.9	927,716	8.6
Interest expense	10,021	0.3	7,338	0.2	24,574	0.2	22,290	0.2
Other expense	1,157	—	1,536	—	2,791	—	2,096	—
Earnings before income taxes	207,957	5.9	210,836	6.2	783,758	6.8	736,499	6.8
Income tax provision	79,758	2.3	80,787	2.4	301,357	2.6	282,279	2.6
NET EARNINGS	$128,199	3.6	$130,049	3.8	$482,401	4.2	$454,220	4.2
WEIGHTED AVERAGE COMMON SHARES:								
Basic	201,291		214,228		205,760		217,568	
Diluted	203,383		217,025		208,242		220,585	
NET EARNINGS PER SHARE:								
Basic	$0.64		$0.61		$2.34		$2.09	
Diluted	$0.63		$0.60		$2.32		$2.06	

[1] Percents are calculated as a percentage of net sales and operating revenues and may not total due to rounding.

See accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended November 30		Nine Months Ended November 30	
(In thousands)	2015	2014	2015	2014
NET EARNINGS	$128,199	$130,049	$482,401	$454,220
Other comprehensive (loss) income, net of taxes:				
Net change in retirement benefit plan unrecognized actuarial losses	322	214	967	640
Net change in cash flow hedge unrecognized losses	(837)	(1,605)	(2,240)	(227)
Other comprehensive (loss) income, net of taxes	(515)	(1,391)	(1,273)	413
TOTAL COMPREHENSIVE INCOME	$127,684	$128,658	$481,128	$454,633

See accompanying notes to consolidated financial statements.

CARMAX, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

(In thousands except share data)	(Unaudited) As of November 30 2015	As of February 28 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$33,346	$27,606
Restricted cash from collections on auto loan receivables	316,186	294,122
Accounts receivable, net	88,530	137,690
Inventory	2,153,270	2,086,874
Deferred income taxes	10,878	8,100
Other current assets	32,673	44,646
TOTAL CURRENT ASSETS	2,634,883	2,599,038
Auto loan receivables, net	9,318,313	8,435,504
Property and equipment, net	2,105,807	1,862,538
Deferred income taxes	174,059	167,638
Other assets	148,103	133,483
TOTAL ASSETS	$14,381,165	$13,198,201
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$420,856	$454,810
Accrued expenses and other current liabilities	211,833	250,307
Accrued income taxes	328	1,554
Short-term debt	36	785
Current portion of long-term debt	—	10,000
Current portion of finance and capital lease obligations	14,673	21,554
Current portion of non-recourse notes payable	275,828	258,163
TOTAL CURRENT LIABILITIES	923,554	997,173
Long-term debt, excluding current portion	864,000	300,000
Finance and capital lease obligations, excluding current portion	391,856	306,284
Non-recourse notes payable, excluding current portion	9,060,090	8,212,466
Other liabilities	229,910	225,493
TOTAL LIABILITIES	11,469,410	10,041,416
Commitments and contingent liabilities	—	—
SHAREHOLDERS' EQUITY:		
Common stock, $0.50 par value; 350,000,000 shares authorized; 197,563,192 and 208,869,688 shares issued and outstanding as of November 30, 2015 and February 28, 2015, respectively	98,781	104,435
Capital in excess of par value	1,136,607	1,123,520
Accumulated other comprehensive loss	(66,664)	(65,391)
Retained earnings	1,743,031	1,994,221
TOTAL SHAREHOLDERS' EQUITY	2,911,755	3,156,785
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$14,381,165	$13,198,201

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended November 30	
(In thousands)	2015	2014
OPERATING ACTIVITIES:		
Net earnings	$482,401	$454,220
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	100,504	84,994
Share-based compensation expense	45,284	57,192
Provision for loan losses	70,165	60,274
Provision for cancellation reserves	61,048	53,764
Deferred income tax benefit	(8,322)	(13,347)
Loss on disposition of assets and other	3,007	2,486
Net decrease (increase) in:		
Accounts receivable, net	49,160	(8,257)
Inventory	(66,396)	(323,249)
Other current assets	12,397	(22,061)
Auto loan receivables, net	(952,974)	(1,050,733)
Other assets	268	(2,910)
Net decrease in:		
Accounts payable, accrued expenses and other current liabilities and accrued income taxes	(109,243)	(16,321)
Other liabilities	(68,878)	(60,667)
NET CASH USED IN OPERATING ACTIVITIES	(381,579)	(784,615)
INVESTING ACTIVITIES:		
Capital expenditures	(240,835)	(238,860)
Proceeds from sales of assets	1,520	5,833
Increase in restricted cash from collections on auto loan receivables	(22,064)	(16,419)
Increase in restricted cash in reserve accounts	(8,383)	(11,323)
Release of restricted cash from reserve accounts	5,907	6,340
Purchases of money market securities, net	(6,106)	(8,604)
Purchases of trading securities	(4,759)	(3,468)
Sales of trading securities	101	333
NET CASH USED IN INVESTING ACTIVITIES	(274,619)	(266,168)
FINANCING ACTIVITIES:		
(Decrease) increase in short-term debt, net	(749)	1,992
Proceeds from issuance of long-term debt	1,137,300	300,000
Payments on long-term debt	(583,300)	—
Cash paid for debt issuance costs	(3,104)	(496)
Payments on finance and capital lease obligations	(13,310)	(13,395)
Issuances of non-recourse notes payable	7,430,805	5,882,000
Payments on non-recourse notes payable	(6,565,516)	(4,950,011)
Repurchase and retirement of common stock	(816,181)	(695,582)

Equity issuances	44,855	54,293
Excess tax benefits from share-based payment arrangements	31,138	33,961
NET CASH PROVIDED BY FINANCING ACTIVITIES	661,938	612,762
Increase (decrease) in cash and cash equivalents	5,740	(438,021)
Cash and cash equivalents at beginning of year	27,606	627,901
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$33,346	$189,880
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	$30,511	$22,232
Cash paid for income taxes	$268,076	$287,905
Non-cash investing and financing activities:		
Increase in accrued capital expenditures	$6,563	$16,538
Increase in finance and capital lease obligations	$92,001	$11,697

See accompanying notes to consolidated financial statements.

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

1. Background

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

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

2. Accounting Policies

Basis of Presentation and Use of Estimates. The accompanying interim unaudited consolidated financial statements include the accounts of CarMax and our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. These consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, such interim consolidated financial statements reflect all normal recurring adjustments considered necessary to present fairly the financial position and the results of operations and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full fiscal year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended February 28, 2015.

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

Cash and Cash Equivalents. Cash equivalents of $78,000 as of November 30, 2015, and $48,000 as of February 28, 2015, consisted of highly liquid investments with original maturities of three months or less.

Restricted Cash from Collections on Auto Loan Receivables. Cash equivalents totaling $316.2 million as of November 30, 2015, and $294.1 million as of February 28, 2015, consisted of collections of principal, interest and fee payments on securitized auto loan receivables that are restricted for payment to the securitization investors pursuant to the applicable securitization agreements.

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

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

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

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

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

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

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

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

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

Property and Equipment. Property and equipment is stated at cost less accumulated depreciation and amortization of $901.6 million and $822.7 million as of November 30, 2015 and February 28, 2015, respectively.

Other Assets. Other assets includes amounts classified as restricted cash on deposit in reserve accounts and restricted investments. The restricted cash on deposit in reserve accounts is for the benefit of holders of non-recourse notes payable, and these funds are not expected to be available to the company or its creditors. In the event that the cash generated by the securitized receivables in a given period was insufficient to pay the interest, principal and other required payments, the balances on deposit in the reserve accounts would be used to pay those amounts. Restricted cash on deposit in reserve accounts is invested in money market securities and was $45.2 million as of November 30, 2015, and $42.7 million as of February 28, 2015.

Restricted investments includes money market securities primarily held to satisfy certain insurance program requirements, as well as mutual funds held in a rabbi trust established to fund informally our executive deferred compensation plan. Restricted investments totaled $63.3 million as of November 30, 2015, and $52.4 million as of February 28, 2015.

Revenue Recognition. We recognize revenue when the earnings process is complete, generally either at the time of sale to a customer or upon delivery to a customer. As part of our customer service strategy, we guarantee the retail vehicles we sell with a 5 day, money-back guarantee. We record a reserve for estimated returns based on historical experience and trends.

We also sell ESP and GAP products on behalf of unrelated third parties, who are the primary obligors, to customers who purchase a vehicle. The ESPs we currently offer on all used vehicles provide coverage of up to 60 months (subject to mileage limitations), while GAP covers the customer for the term of their finance contract. We recognize commission revenue at the time of sale, net of a reserve for estimated contract cancellations. Periodically, we may receive additional commissions based upon the level of

underwriting profits of the third parties who administer the products. These additional commissions are recognized as revenue when received. The reserve for cancellations is evaluated for each product, and is based on forecasted forward cancellation curves utilizing historical experience, recent trends and credit mix of the customer base. Our risk related to contract cancellations is limited to the commissions that we receive. Cancellations fluctuate depending on the volume of EPP sales, customer financing default or prepayment rates, and shifts in customer behavior, including those related to changes in the coverage or term of the product. The current portion of estimated cancellation reserves is recognized as a component of accrued expenses and other current liabilities with the remaining amount recognized in other liabilities. See Note 7 for additional information on cancellation reserves.

Customers applying for financing who are not approved or are conditionally approved by CAF are generally evaluated by third-party finance providers. These providers generally either pay us or are paid a fixed, pre-negotiated fee per contract. We recognize these fees at the time of sale.

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

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

Recent Accounting Pronouncements.

Effective in Future Periods. In November 2015, the Financial Accounting Standards Board ("FASB") issued an accounting pronouncement (FASB ASU 2015-17) which simplifies the balance sheet classification of deferred taxes. This pronouncement requires that all deferred tax assets and liabilities be classified as noncurrent in the classified balance sheet, rather than separating such deferred taxes into current and noncurrent amounts, as is required under current guidance. This pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016, and may be applied either prospectively or retrospectively. This pronouncement would be effective for our fiscal year beginning March 1, 2017, but early adoption is permitted. We are currently in the process of evaluating the effects of this pronouncement on our consolidated financial statements, including potential early adoption.

In January 2016, the FASB issued an accounting pronouncement (FASB ASU 2016-01) related to financial instruments (FASB ASC Subtopic 825-10). This pronouncement requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The pronouncement also impacts financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. The pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. We will adopt this pronouncement for our fiscal year beginning March 1, 2018, and are currently evaluating the effect on our consolidated financial statements.

3. CarMax Auto Finance

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

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

CAF income does not include any allocation of indirect costs. Although CAF benefits from certain indirect overhead expenditures, we have not allocated indirect costs to CAF to avoid making subjective allocation decisions. Examples of indirect costs not allocated to CAF include retail store expenses and corporate expenses such as human resources, administrative services, marketing, information systems, accounting, legal, treasury and executive payroll. In addition, except for auto loan receivables, which are

disclosed in Note 4, CAF assets are not separately reported nor do we allocate assets to CAF because such allocation would not be useful to management in making operating decisions.

Components of CAF Income

	Three Months Ended November 30				Nine Months Ended November 30			
(In millions)	2015	% [1]	2014	% [1]	2015	% [1]	2014	% [1]
Interest margin:								
Interest and fee income	$172.3	7.4	$152.7	7.6	$507.0	7.5	$450.4	7.8
Interest expense	(33.0)	(1.4)	(24.8)	(1.2)	(91.9)	(1.4)	(71.8)	(1.2)
Total interest margin	139.3	6.0	127.9	6.4	415.1	6.2	378.6	6.5
Provision for loan losses	(30.9)	(1.3)	(24.1)	(1.2)	(70.2)	(1.0)	(60.3)	(1.0)
Total interest margin after provision for loan losses	108.4	4.7	103.8	5.2	344.9	5.1	318.3	5.5
Total other expense	(0.3)	—	—	—	(0.4)	—	—	—
Direct expenses:								
Payroll and fringe benefit expense	(7.1)	(0.3)	(6.3)	(0.3)	(21.0)	(0.3)	(18.8)	(0.3)
Other direct expenses	(8.7)	(0.4)	(7.8)	(0.4)	(23.8)	(0.4)	(22.6)	(0.4)
Total direct expenses	(15.8)	(0.7)	(14.1)	(0.7)	(44.8)	(0.7)	(41.4)	(0.7)
CarMax Auto Finance income	$92.3	4.0	$89.7	4.5	$299.7	4.5	$276.9	4.8
Total average managed receivables	$9,261.4		$8,026.2		$8,973.3		$7,713.6	

(1) Annualized percentage of total average managed receivables.

4. Auto Loan Receivables

Auto loan receivables include amounts due from customers related to retail vehicle sales financed through CAF and are presented net of an allowance for estimated loan losses. We generally use warehouse facilities to fund auto loan receivables originated by CAF until we elect to fund them through a term securitization or alternative funding arrangement. The majority of the auto loan receivables serve as collateral for the related non-recourse notes payable of $9.34 billion as of November 30, 2015 and $8.47 billion as of February 28, 2015. See Notes 2 and 10 for additional information on securitizations and non-recourse notes payable.

Auto Loan Receivables, Net

	As of November 30	As of February 28
(In millions)	2015	2015
Warehouse facilities	$1,391.0	$986.0
Term securitizations	7,669.1	7,226.5
Other receivables [1]	311.4	246.2
Total ending managed receivables	9,371.5	8,458.7
Accrued interest and fees	37.4	31.2
Other	0.3	27.3
Less allowance for loan losses	(90.9)	(81.7)
Auto loan receivables, net	$9,318.3	$8,435.5

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

Credit Quality. When customers apply for financing, CAF's proprietary scoring models rely on the customers' credit history and certain application information to evaluate and rank their risk. We obtain credit histories and other credit data that includes information such as number, age, type of and payment history for prior or existing credit accounts. The application information that is used includes income, collateral value and down payment. The scoring models yield credit grades that represent the relative likelihood of repayment. Customers assigned a grade of "A" are determined to have the highest probability of repayment, and

customers assigned a lower grade are determined to have a lower probability of repayment. For loans that are approved, the credit grade influences the terms of the agreement, such as the required loan-to-value ratio and interest rate.

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

Ending Managed Receivables by Major Credit Grade

	As of November 30		As of February 28	
(In millions)	2015 [1]	% [2]	2015 [1]	% [2]
A	$4,553.9	48.6	$4,135.6	48.9
B	3,340.1	35.6	3,055.3	36.1
C and other	1,477.5	15.8	1,267.8	15.0
Total ending managed receivables	$9,371.5	100.0	$8,458.7	100.0

(1) Classified based on credit grade assigned when customers were initially approved for financing.
(2) Percent of total ending managed receivables.

Allowance for Loan Losses

	Three Months Ended November 30				Nine Months Ended November 30			
(In millions)	2015	% [1]	2014	% [1]	2015	% [1]	2014	% [1]
Balance as of beginning of period	$87.8	0.96	$77.8	0.99	$81.7	0.97	$69.9	0.97
Charge-offs	(51.9)		(43.8)		(128.7)		(112.7)	
Recoveries	24.1		22.3		67.7		62.9	
Provision for loan losses	30.9		24.1		70.2		60.3	
Balance as of end of period	$90.9	0.97	$80.4	0.98	$90.9	0.97	$80.4	0.98

(1) Percent of total ending managed receivables.

The allowance for loan losses represents an estimate of the amount of net losses inherent in our portfolio of managed receivables as of the applicable reporting date and anticipated to occur during the following 12 months. The allowance is primarily based on the credit quality of the underlying receivables, historical loss trends and forecasted forward loss curves. We also take into account recent trends in delinquencies and losses, recovery rates and the economic environment. The provision for loan losses is the periodic expense of maintaining an adequate allowance.

Past Due Receivables

	As of November 30		As of February 28	
(In millions)	2015	% [1]	2015	% [1]
Total ending managed receivables	$9,371.5	100.0	$8,458.7	100.0
Delinquent loans:				
31-60 days past due	$201.1	2.1	$152.1	1.8
61-90 days past due	78.7	0.8	52.5	0.6
Greater than 90 days past due	24.1	0.3	16.8	0.2
Total past due	$303.9	3.2	$221.4	2.6

(1) Percent of total ending managed receivables.

5. Derivative Instruments and Hedging Activities

Risk Management Objective of Using Derivatives. We use derivatives to manage certain risks arising from both our business operations and economic conditions, particularly with regard to future issuances of fixed-rate debt and existing issuances of floating-rate debt. Primary exposures include LIBOR and other rates used as benchmarks in our securitizations and other debt

financing. We enter into derivative instruments to manage exposures related to the future known receipt or payment of uncertain cash amounts, the values of which are impacted by interest rates. Our derivative instruments are used to manage (i) differences in the amount of our known or expected cash receipts and our known or expected cash payments principally related to the funding of our auto loan receivables, and (ii) exposure to variable interest rates associated with our term loan, as further discussed in Note 10.

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

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

Designated Cash Flow Hedges – Securitizations. Our objectives in using interest rate derivatives in conjunction with our securitization program are to add stability to CAF's interest expense, to manage our exposure to interest rate movements and to better match funding costs to the interest received on the receivables being securitized.

To accomplish these objectives, we primarily use interest rate swaps that involve the receipt of variable amounts from a counterparty in exchange for our making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. These interest rate swaps are hedges of forecasted interest payments in anticipation of permanent funding in the term securitization market.

For these derivatives, the effective portion of changes in the fair value is initially recorded in accumulated other comprehensive loss ("AOCL"). These amounts are subsequently reclassified into CAF income in the period that the hedged forecasted transaction affects earnings, which occurs as interest expense is recognized on those future issuances of fixed-rate debt. During the next 12 months, we estimate that an additional $7.2 million will be reclassified from AOCL as a decrease to CAF income.

In addition, we have issued floating rate notes in connection with some of our term securitizations. To manage our exposure to interest rate movements, we have entered into interest rate swaps that involve the receipt of variable amounts from a counterparty in exchange for making fixed-rate payments over the estimated life of the note. The effective portion of the change in fair value for these derivatives is recorded in AOCL.

Any ineffective portion of these derivatives is recognized directly in CAF income.

Designated Cash Flow Hedge – Other Debt. Our objective in using an interest rate derivative for our term loan is to manage our exposure to interest rate movements. To accomplish this objective, we use an interest rate swap that involves the receipt of variable amounts from a counterparty in exchange for our making fixed-rate payments without exchange of the underlying notional amount. The effective portion of the change in fair value for this derivative is recorded in AOCL. Any ineffective portion of the change in fair value is recognized in current income.

Fair Values of Derivative Instruments

	As of November 30, 2015		As of February 28, 2015	
(In thousands)	Assets [1]	Liabilities [2]	Assets [1]	Liabilities [2]
Derivatives designated as accounting hedges:				
Interest rate swaps	$ 1,625	(1,632)	$ 1,201	(1,064)

[1] Reported in other current assets on the consolidated balance sheets.
[2] Reported in accounts payable on the consolidated balance sheets.

As of November 30, 2015 and February 28, 2015, we had interest rate swaps outstanding with a combined notional amount of $2.30 billion and $1.40 billion, respectively, that were designated as cash flow hedges of interest rate risk.

Effect of Derivative Instruments on Comprehensive Income

(In thousands)	Three Months Ended November 30 2015	Three Months Ended November 30 2014	Nine Months Ended November 30 2015	Nine Months Ended November 30 2014
Derivatives designated as accounting hedges:				
Loss recognized in AOCL [1]	$(3,325)	$(4,525)	$(9,596)	$(6,594)
Loss reclassified from AOCL into CAF income [1]	$(1,944)	$(1,881)	$(5,902)	$(6,220)
Loss recognized in CAF Income [2]	$(336)	$—	$(438)	$—

(1) Represents the effective portion.
(2) Represents the ineffective portion.

6. Fair Value Measurements

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

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

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

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

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

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

Valuation Methodologies

Money Market Securities. Money market securities are cash equivalents, which are included in cash and cash equivalents, restricted cash from collections on auto loan receivables or other assets. They consist of highly liquid investments with original maturities of three months or less. We use quoted market prices for identical assets to measure fair value. Therefore, all money market securities are classified as Level 1.

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

Derivative Instruments. The fair values of our derivative instruments are included in either other current assets or accounts payable. As described in Note 5, as part of our risk management strategy, we utilize derivative instruments to manage differences in the amount of our known or expected cash receipts and our known or expected cash payments principally related to the funding of our auto loan receivables as well as to manage exposure to variable interest rates on our term loan. Our derivatives are not exchange-traded and are over-the-counter customized derivative instruments. All of our derivative exposures are with highly rated bank counterparties.

We measure derivative fair values assuming that the unit of account is an individual derivative instrument and that derivatives are sold or transferred on a stand-alone basis. We estimate the fair value of our derivatives using quotes determined by the derivative

counterparties and third-party valuation services. Quotes from third-party valuation services and quotes received from bank counterparties project future cash flows and discount the future amounts to a present value using market-based expectations for interest rates and the contractual terms of the derivative instruments. The models do not require significant judgment and model inputs can typically be observed in a liquid market; however, because the models include inputs other than quoted prices in active markets, all derivatives are classified as Level 2.

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

Items Measured at Fair Value on a Recurring Basis

	As of November 30, 2015		
(In thousands)	Level 1	Level 2	Total
Assets:			
Money market securities	$410,777	$—	$410,777
Mutual fund investments	13,989	—	13,989
Derivative instruments	—	1,625	1,625
Total assets at fair value	$424,766	$1,625	$426,391
Percent of total assets at fair value	99.6 %	0.4 %	100.0 %
Percent of total assets	3.0 %	— %	3.0 %
Liabilities:			
Derivative instruments	$—	$(1,632)	$(1,632)
Total liabilities at fair value	$—	$(1,632)	$(1,632)
Percent of total liabilities	— %	— %	— %

	As of February 28, 2015		
(In thousands)	Level 1	Level 2	Total
Assets:			
Money market securities	$380,100	$—	$380,100
Mutual fund investments	9,242	—	9,242
Derivative instruments	—	1,201	1,201
Total assets at fair value	$389,342	$1,201	$390,543
Percent of total assets at fair value	99.7 %	0.3 %	100.0 %
Percent of total assets	2.9 %	— %	3.0 %
Liabilities:			
Derivative instruments	$—	$(1,064)	$(1,064)
Total liabilities at fair value	$—	$(1,064)	$(1,064)
Percent of total liabilities	— %	— %	— %

There were no transfers between Levels 1 and 2 for the three and nine months ended November 30, 2015.

7. Cancellation Reserves

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

Cancellation Reserves

	Three Months Ended November 30		Nine Months Ended November 30	
(In millions)	2015	2014	2015	2014
Balance as of beginning of period	$108.1	$86.0	$94.4	$72.5
Cancellations	(16.9)	(12.4)	(45.6)	(37.4)
Provision for future cancellations	18.6	15.3	61.0	53.8
Balance as of end of period	$109.8	$88.9	$109.8	$88.9

The current portion of estimated cancellation reserves is recognized as a component of accrued expenses and other current liabilities with the remaining amount recognized in other liabilities. As of November 30, 2015 and February 28, 2015, the current portion of cancellation reserves was $53.1 million and $44.8 million, respectively.

8. Income Taxes

We had $27.5 million of gross unrecognized tax benefits as of November 30, 2015, and $25.0 million as of February 28, 2015. There were no significant changes to the gross unrecognized tax benefits as reported for the year ended February 28, 2015, as all activity was related to positions taken on tax returns filed or intended to be filed in the current fiscal year.

9. Retirement Plans

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

Components of Net Pension Expense

	Three Months Ended November 30					
	Pension Plan		Restoration Plan		Total	
(In thousands)	2015	2014	2015	2014	2015	2014
Interest cost	$2,168	$2,008	$107	$113	$2,275	$2,121
Expected return on plan assets	(2,463)	(2,257)	—	—	(2,463)	(2,257)
Recognized actuarial loss	507	340	7	—	514	340
Net pension expense	$212	$91	$114	$113	$326	$204

	Nine Months Ended November 30					
	Pension Plan		Restoration Plan		Total	
(In thousands)	2015	2014	2015	2014	2015	2014
Interest cost	$6,504	$6,024	$323	$339	$6,827	$6,363
Expected return on plan assets	(7,392)	(6,771)	—	—	(7,392)	(6,771)
Recognized actuarial loss	1,524	1,020	19	—	1,543	1,020
Net pension expense	$636	$273	$342	$339	$978	$612

We made no contributions to the pension plan during the nine months ended November 30, 2015, and do not anticipate making any contributions during the remainder of fiscal 2016. The expected long-term rate of return on

plan assets for the pension plan was 7.75% as of February 28, 2015.

10. Debt

(In thousands)	As of November 30 2015	As of February 28 2015
Short-term borrowings on revolving credit facility	$36	$785
Current portion of long-term debt	—	10,000
Current portion of finance and capital lease obligations	14,673	21,554
Current portion of non-recourse notes payable	275,828	258,163
Total current debt	290,537	290,502
Long-term debt	864,000	300,000
Finance and capital lease obligations, excluding current portion	391,856	306,284
Non-recourse notes payable, excluding current portion	9,060,090	8,212,466
Total debt, excluding current portion	10,315,946	8,818,750
Total debt	$10,606,483	$9,109,252

Revolving Credit Facility. We have a $1.2 billion unsecured revolving credit facility (the "credit facility") with various financial institutions that expires in August 2020. Borrowings under the credit facility are available for working capital and general corporate purposes. Borrowings accrue interest at variable rates based on LIBOR, the federal funds rate, or the prime rate, depending on the type of borrowing, and we pay a commitment fee on the unused portions of the available funds. Borrowings under the credit facility are either due "on demand" or at maturity depending on the type of borrowing. Borrowings with "on demand" repayment terms are presented as short-term debt while amounts due at maturity are presented as long-term debt with expected repayments within the next twelve months presented as a component of current portion of long-term debt. Outstanding borrowings of $564.0 million at November 30, 2015 are classified as long-term debt as no repayments are scheduled to be made within the next twelve months. However, conditions may change and we may elect to make payments. As of November 30, 2015, the unused capacity of $636.0 million was fully available to us.

Term Loan. We have a $300 million term loan that expires in August 2020. The term loan accrues interest at variable rates based on the LIBOR rate, the federal funds rate, or the prime rate. As of November 30, 2015, $300 million remained outstanding and was classified as long-term debt as no repayments are scheduled to be made within the next 12 months. Borrowings under the term loan are available for working capital and general corporate purposes. We have entered into an interest rate derivative contract to manage our exposure to variable interest rates associated with this term loan.

Finance and Capital Lease Obligations. Finance and capital lease obligations relate primarily to stores subject to sale-leaseback transactions that did not qualify for sale accounting, and therefore, are accounted for as financings. The leases were structured at varying interest rates and generally have initial lease terms ranging from 15 to 20 years with payments made monthly. Payments on the leases are recognized as interest expense and a reduction of the obligations. We have not entered into any new sale-leaseback transactions since fiscal 2009. During fiscal 2016, finance lease obligations were increased by $92.0 million related to leases that were modified or extended beyond the original lease term.

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

As of November 30, 2015, $7.94 billion of non-recourse notes payable was outstanding related to term securitizations. These notes payable accrue interest predominantly at fixed rates and have scheduled maturities

through May 2022, but may mature earlier, depending upon the repayment rate of the underlying auto loan receivables.

As of November 30, 2015, $1.39 billion of non-recourse notes payable was outstanding related to our warehouse facilities. During the first nine months of fiscal 2016, we increased the combined limit of our warehouse facilities by $200 million to $2.5 billion. As of November 30, 2015, the unused warehouse capacity totaled $1.11 billion. Of the combined warehouse facility limit, $1.5 billion will expire in February 2016 and $1.0 billion will expire in August 2016. The return requirements of warehouse facility investors could fluctuate significantly depending on market conditions. At renewal, the cost, structure and capacity of the facilities could change. These changes could have a significant impact on our funding costs.

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

Capitalized Interest. We capitalize interest in connection with the construction of certain facilities. We capitalized interest of $7.6 million in the first nine months of fiscal 2016; no interest was capitalized in the first nine months of fiscal 2015.

Financial Covenants. The credit facility and term loan agreements contain representations and warranties, conditions and covenants. We must also meet financial covenants in conjunction with certain of the sale-leaseback transactions. Our securitization agreements contain representations and warranties, financial covenants and performance triggers. As of November 30, 2015, we were in compliance with all financial covenants and our securitized receivables were in compliance with the related performance triggers.

11. Stock and Stock-Based Incentive Plans

(A) Share Repurchase Program
In fiscal 2013, our board of directors authorized the repurchase of up to $800 million of our common stock which was exhausted in fiscal 2015. In fiscal 2015, our board of directors authorized the repurchase of up to an additional $3 billion of our common stock of which $1 billion was exhausted during the quarter ended August 31, 2015, and $2 billion expires on December 31, 2016.

Common Stock Repurchases

	Three Months Ended November 30		Nine Months Ended November 30	
	2015	2014	2015	2014
Number of shares repurchased (in thousands)	7,680.8	6,234.8	13,336.1	14,101.5
Average cost per share	$58.03	$52.48	$61.14	$49.80
Available for repurchase, as of end of period (in millions)	$1,553.8	$2,579.8	$1,553.8	$2,579.8

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

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

Nonqualified Stock Options. Nonqualified stock options are awards that allow the recipient to purchase shares of our common stock at a fixed price. Stock options are granted at an exercise price equal to the fair market value of our common stock on the grant date. The stock options generally vest annually in equal amounts over periods of one&#