THE STAHL REPORT

July 12, 2010

CarMax, Inc.

(BUY)

Price:	$20.15	**Ticker:**	KMX
52-Week Range:	$13.06-$26.50	**Dividend:**	None
Shares Outstanding:	226.2m	**Yield:**	n/a
Market Capitalization:	$4,558m		

Data As of 7/7/2010
Valuations within the text are based on a $19.86 share price.

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Investment Thesis

The U.S. automobile industry has suffered its fair share of difficulties over the last several years. Some would even declare that the industry has been in a state of complete disarray. While bankruptcies at the manufacturer and supplier levels have indeed altered the landscape, the automobile retailers have experienced a somewhat different and more positive fate.

Over the past decade, there has been a gradual elimination of auto retail competition. Most recently, the bankruptcies of General Motors and Chrysler, and the near bankruptcy of Ford, caused these companies to close a number of dealerships that were not producing sufficient sales. This natural attrition has given existing retailers a distinct operating advantage.

But, more importantly, the dealership industry has been in steady consolidation mode for at least the past decade. The company known as AutoNation has been one of the more aggressive acquirers of local dealerships. There is little doubt, as observed in the company's profitability record, that auto retailing manifests a clear economy of scale. For the first time perhaps in the history of the auto industry, large conglomerate dealerships are beginning to exert a certain degree of leverage over the manufacturers.

CarMax is the largest used vehicle retailer in the United States. While there is clearly a distinction between the used and new vehicle markets, CarMax is benefiting from the same consolidation and competitive features of the entire industry. Originally part of Circuit City Stores, and then formally spun out of this parent in 2002, CarMax developed a "superstore" retail format that focused on selling high quality, low mileage used vehicles. The company grew rather rapidly by opening new stores at a 24.8% annual rate during the 1997-2009 fiscal year period. Yet, the 357,129 vehicles sold last year at the company's 100 locations represents merely 2% of the used vehicle industry's total sales. The reader will find it evident that 2% market share for the industry's largest company reflectsan enormously fragmented market that could undergo future consolidation for many years. In this regard, the company reports that there are approximately 36,500 used car dealerships in the U.S., a number which has been in steady decline for the last 10 years.

At this point, CarMax has grown primarily through new store growth rather than through the acquisition of existing dealerships. The benefits of this expansion are expressed in the company's recent profitability history. For instance, the gross margin has risen from 12.4% in 2001 when the company operated 40 locations, to the current 14.7% level for its 100-location chain, which represents an improvement of 18.5%. In addition, during the same period the net profit margin has increased to 3.8% from 1.7%, for a cumulative margin improvement of 124%.

CarMax intends to resume its new store growth during the current fiscal year by opening three additional locations, which was preceded by a reduction in capital expenditures and store openings during the recent recession. It is nothing other than reasonable to presume that several years of expansion could lie ahead for the company, given its unsubstantial current market share position represented by operations in only 26 states presently.

The current 13.9x p/e ratio that is based on estimated 2011 fiscal year consensus earnings reflects the currently depressed level of automobile sales. Obviously a cyclical industry, the present 11.1 million seasonally adjusted U.S. vehicle sales rate could be compared to a more robust period of 16.9 million vehicles sold in 2004. To assume that automobile sales will remain permanently low, rather than being merely a transitory decline, is a somewhat draconian posture, although this is the reality of the company's valuation. Over time, CarMax will indeed increase its store locations, and actually plans to expand its store capacity by 14% over the next three years. This could very well be accompanied by additional margin progress, as was the case historically. As a simple arbitrary example, if CarMax could achieve merely a 4.5% net margin in relation to the present 3.8% level, the earnings improvement would be 18.4%, absent any increase in sales.

It is somewhat difficult to argue against the notion that CarMax possesses earnings potential far beyond the current low valuation and earnings environments. As recently as in 2008, the shares traded at a 22.4x earnings multiple. If the company's long-term growth prospects have not diminished since then, it is arguable that the current valuation can again expand, although that is not a precondition for a remunerative investment in the shares. By simply accounting for new store growth, possible margin expansion, and improved auto sales conditions, the intrinsic value of this company could well increase at a reasonably high double digit rate for an extended period of time. Yet, it appears that these growth qualities are being masked by investors' inability to view the company beyond its current cyclical dimensions. Accordingly, purchase of CarMax is recommended.

Company Description

Historical Origin

CarMax was initially developed within the corporate planning activities of Circuit City Stores during the early 1990s. While Circuit City had been an electronics retailer, the company chose to invest roughly $50 million of start-up capital into an area of retail that was believed to be underserved by a large national chain format. In 1993, the concept of CarMax was introduced in a single location in Richmond, Virginia. Following the success of this initial dealership, the company pursued additional store locations along the East Coast. By 1997, the CarMax business had prospered mightily, and Circuit City chose to list the shares separately through a tracking stock. This offering provided a repayment of sorts for the growth capital invested by Circuit City, and also funded additional expansion by CarMax into other markets of the U.S. CarMax opened 33 stores during the 1997-2002 period, as demonstrated in the table below.

Table 1: Historical CarMax Store Location Growth

Year	Total Stores	% *change*
2010	100	*0.0%*
2009	100	*12.4%*
2008	89	*15.6%*
2007	77	*8.5%*
2006	71	*16.4%*
2005	61	*17.3%*
2004	52	*18.2%*
2003	44	*10.0%*
2002	40	*0.0%*
2001	40	*0.0%*
2000	40	*29.0%*
1999	31	*72.2%*
1998	18	*157.1%*
1997	7	

After having achieved profitability in 2000, it was evident that CarMax could operate as a standalone entity funded by its own cash flow. This being the case, the shares were officially spun out of Circuit City in 2002, followed by a period during which CarMax expanded its store count rather aggressively to the current 100 locations.

Business Description

The genesis of CarMax was to create a used vehicle franchise that addressed the overriding concern or dissatisfaction voiced by consumers, which is that of a pressure-driven environment riddled with price haggling. CarMax offers fixed prices on its used vehicles, which eliminates the redundant sales tactics practiced by many dealerships. In addition to the traditional trade-in practice, CarMax also purchases vehicles outright from consumers without obliging the consumers to purchase another vehicle. This rather unique strategy has resonated with consumers, which can be expressed through the company's financial performance that will be discussed momentarily.

CarMax generally only purchases and resells vehicles that are 1-6 years old with under 60,000 miles, although a small percentage of older vehicle models are sold at the company's locations. This focus on newer used vehicles has positioned the company as a quality-driven dealership to be separated from the literally thousands of used car dealerships with questionable business practices that personify the industry.

CarMax sells most of the recognized automobile brands such as Ford, Chrysler, General Motors, Honda, Mazda, Kia, Nissan, Toyota, Lexus, Infinity, BMW, and Mercedes. While the core of the business is focused on newer vehicles that range in price from $11,000 to $30,000, older vehicles with in excess of 60,000 miles and priced in the $8,000 to $21,000 price range are also sold in limited fashion.

The two primary sources of vehicle supply are customer trade-in's and wholesale purchases. At the trade-in level, if the vehicle does not meet certain quality specifications, it is sold in the wholesale market to other dealerships. During the 2010 fiscal year ending in February, 197,382, or 35.1% of the total 562,362 CarMax vehicle unit sales were sold to wholesale buyers. The unit profitability of wholesale transactions is actually substantially higher than that of used vehicle sales, which is somewhat counterintuitive, given the volume discount that likely applies. However, these vehicles typically do not undergo a reconditioning expense and are sold "as-is" to the wholesaler. As a result, the fiscal year 2010 gross margin on wholesale transactions was 20.3%, which will be viewed in relation to the 11.9% gross margin of used vehicle sales.

It should also be noted that CarMax sells new vehicles at five of its locations. It currently has franchise agreements with Chrysler, General Motors, Nissan, and Toyota. This has not been a focus of the company, because new vehicle retail has distinct differences from used vehicle retail. That is, the new vehicle retailer is dependent on rebate and other incentive measures assigned by the manufacturer. Pricing terms also tend to be more rigid, as the manufacturers establish pricing parameters for their vehicles. The margin of profitability, at least in the case of CarMax, is quite low in this business. For example, the gross margin on new vehicles was recently 3.6%. Since there exists more of a free market in the used vehicle industry, or at least one that is not dictated by manufacturer pricing policies, CarMax has not placed much emphasis on new vehicle sales. Currently, only 1.4% of the company's total sales volume is represented by new vehicle transactions. As an aside, it should actually be noted that the most profitable portion of a dealership is the service and repair business. Oftentimes, this represents a disproportionate amount of dealership gross profit relative to vehicle sales.

CarMax also operates its own captive finance subsidiary known as CarMax Auto Finance ("CAF"). During 2010, this function provided financing for 35% of the company's total vehicle sales. The balance of customer transactions is financed by third-party lenders such as Wells Fargo or Capital One. Substantially all of the loans originated by CAF are resold in the securitization market, for which there is very little recourse or credit risk to CarMax. In these cases, CarMax merely services the securitized portfolio.

However, a small portion of the receivable interest has been retained historically by CarMax. As of February 2010, CarMax had retained $552.4 million of the securitized interest on its balance sheet. When the securitization market more or less shut down in 2008, the company experienced mark-to-market losses on this portfolio, which dramatically reduced reported finance income. The actual delinquency rate on the overall managed portfolio rose from 2.24% in 2008 to 3.24% in 2010. Nevertheless, the balance sheet was not materially impaired, because the retained securitized assets represented only approximately 22% of the company's total assets, and debt that was actually recourse to the company remained at an immaterial level. Now that the debt markets have resumed a reasonable state of normalcy, CAF appears to be functioning properly again.

CarMax: The Last Ten Years of Expansion

The Dealership Industry

According to the National Automobile Dealers Association ("NADA"), there existed 20,010 new vehicle dealerships in the United States at the end of 2009. There has been a steady decline since 1988, at which time there existed 25,025 dealerships. This represents an enormous 20% reduction in the number of auto retail locations. According to NADA, the alteration of the industry has been due to consolidation by large national dealerships, such as those owned by AutoNation. Only most recently have the manufacturers begun to close down underperforming franchises, but nevertheless thereby exacerbating the decline. Notwithstanding this consolidation, if one were to sum the total franchises and dealerships owned by the publicly traded auto retailers, which happens to be 1,061, these companies represent merely 5.3% of all U.S. dealership locations.

CarMax reports that there are roughly 36,500 used vehicle dealerships, a number which the company reports has also been in decline for the past decade. This is logical in that most new car dealerships also sell used vehicles, such that this has functionally been a consolidation of both subsets of the industry. Nevertheless, the 100 CarMax locations represent merely 0.3% of the industry's dealerships. Similarly, the company's most recently recorded annual used vehicle sales volume of 357,129 units accounted for 2.4% of the estimated 15 million unit sales of late model vehicles. In simplistic terms, CarMax could effectively double or triple in size through its expansion efforts, and likely have very little impact on the dynamics of the industry.

CarMax is somewhat unique in that it clearly benefits from consolidation trends within the industry. However, it has not really contributed to the consolidation by actively acquiring businesses. It is actually growing through internal expansion, and constructing operational scale in this manner. By virtue of its store growth, as outlined previously, CarMax has increased its total vehicle sales at a rapid rate since the mid-1990s. The table below presents a 20.5% annualized rate of expansion since 1997.

Table 2: Historical CarMax Vehicle Unit Sales

Year	Used Vehicles	Wholesale Vehicles	New Vehicles	Total	*% change*
2010	357,129	197,382	7,851	562,362	*2.1%*
2009	345,465	194,081	11,084	550,630	*-10.5%*
2008	377,244	222,406	15,485	615,135	*9.0%*
2007	337,021	208,959	18,563	564,543	*15.1%*
2006	289,888	179,548	20,901	490,337	*14.2%*
2005	253,168	155,393	20,636	429,197	*15.1%*
2004	224,099	127,168	21,641	372,908	*17.6%*
2003	190,135	104,593	22,360	317,088	*13.6%*
2002	164,062	90,937	24,164	279,163	*23.3%*
2001	132,868	73,323	20,157	226,348	*20.7%*
2000	111,247	58,452	17,775	187,474	*25.1%*
1999	96,915	46,784	6,152	149,851	*75.6%*
1998	56,594	24,475	4,265	85,334	*71.5%*
1997	31,701	15,252	2,799	49,752	
Annl'zd %:	*20.5%*	*21.8%*	*8.3%*	*20.5%*	

This volume expansion has produced a marked improvement in profitability through the years. For instance, the company's net margin during 2001, while indeed a recessionary period, was 1.7%. Net profitability gradually rose to the 2.7% level in the 2007 fiscal year, only to suffer a decline in the 2008-2009 recessionary period. Clearly, CarMax is a cyclical company that generally will not escape periods of retrenchment in automobile sales. Yet, apart from this obvious variability, the increasing size of its operations has produced a more substantial presence within the industry. This likely generates more effective buying power at the wholesale level, and certainly at the individual customer level. By lowering its cost of goods, the gross margin has been expanding for much of the past decade, as presented below.

Table 3: CarMax Historical Profitability Measures

Fiscal Year	Gross %	Net %
2011 est	n/a	3.9%
2010	14.7%	3.8%
2009	13.9%	0.8%
2008	13.1%	2.2%
2007	13.0%	2.7%
2006	12.6%	2.1%
2005	12.4%	1.9%
2004	12.4%	2.5%
2003	11.8%	2.4%
2002	11.9%	2.6%
2001	12.4%	1.7%

The reader might also wish to view the more recent gross margin experience of AutoNation. As the largest new vehicle auto dealership in the U.S., a distinction achieved through a gradual acquisition strategy, the company's gross margin was 15% in 2001. At the most recent reckoning, AutoNation produced 17.9% gross profitability, even despite one of the more treacherous periods in automobile sales history. The profit dimensions for the large and expanding dealerships are clearly shifting in their favor. It appears that CarMax, as a relatively new entrant in the business, may well have more margin expansion ahead, as shown in the comparison table below.

Table 4: Dealership Gross Margin Comparison

Company	Most Recent Year End Gross Margin
AutoNation	17.9%
Penske Automotive Group	16.6%
Group 1 Automotive	17.2%
Sonic Automotive	17.0%
Asbury Automotive Group	16.8%
America's Car-Mart	49.0%
Lithia Motors	18.9%
CarMax	14.7%

The noted outlier here is the company known as America's Car-Mart, which is an interesting company. It primarily sells older used vehicles to smaller or somewhat rural

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populations in the South and Midwest. The average sale price of its vehicles is roughly $9,000, so it is targeting the lower end consumer. However, many of its customers have poor credit, or cannot otherwise obtain auto financing. In this sense, the company is a sub-prime auto lender of sorts. The key to the company's profitability, since credit losses were recently 18% of its revenues, is sufficient collection of the receivables portfolio. While the business model is starkly different from that of CarMax, America's Car-Mart has clearly carved out a niche within the auto retail industry, and actually has had reasonable success despite the inherent risk of its strategy.

CarMax During Recession

It has been established that CarMax has cyclical manifestations. Since the company was really first reported within Circuit City in 1997, it has experienced two recessions, and it is therefore worthwhile studying these periods. In the 2001-2003 recession, the company produced increases in both earnings and revenues. One might quickly argue that CarMax was still in an early growth stage, thereby allowing the company to grow during an economic contraction. It should be noted though that CarMax did not open any new stores from 2000-2002. In any case, CarMax was relatively unharmed during that particular recession.

The more recent period was not merely a recession but, more importantly, a crisis of liquidity. The lack of an asset-backed securitization market impaired the ability of many companies to provide financing for customers, which is a severe problem for an auto retailer. As a result, U.S. auto sales fell dramatically, and are still 34% below the 2004 level. The CarMax sales fell by 10.5% during the 2009 fiscal year, resulting in a 15% decline in revenues. Due to the mark-to-market losses in the company's financing division, net income was diminished by 68%. In response, CarMax postponed its store expansion plans in order to accumulate a cash reserve on its balance sheet necessary to weather the effects of the Credit Crisis.

Table 5: The CarMax Cyclical Experience

Fiscal Year	Sales	Net Income
2010	$7,470	$282
2009	$6,974	$59
2008	$8,200	$182
2007	$7,466	$199
2006	$6,260	$134
2005	$5,260	$101
2004	$4,598	$117
2003	$3,970	$95
2002	$3,534	$91
2001	$2,759	$46

The absolute declines are easily anticipated for a company of this character. Importantly, though, this was merely a temporary disruption to an otherwise substantial increase in profitability. For instance, as previously noted, the gross margin has improved from a pre-recessionary level of 13% to the current 14.7% achievement. This has been a function of the used vehicle gross profit per unit, which has expanded from $1,808 in the 2006 fiscal year to $2,212 presently. In 2011, CarMax is forecasted to produce a 3.9% net margin, which would be an improvement of 44% from the highest pre-recession margin ever achieved of 2.7% in 2007. Hence, there has been no diminution of the company's ability to generate margin progress amid a severe erosion of U.S. automobile sales.

The Recent Accounting Change with Respect to CAF
Historically, CAF securitized most of its loan portfolio to third-party investors, which in essence moved the receivables off-balance sheet. There is nothing improper about this reporting method, since CAF did not incur any residual credit risk once the receivables were purchased by the securitized trust. It does not appear that this securitization practice will change; however, recent accounting rules have required the company to report the loan portfolio on its balance sheet. As a result, during the 1st quarter of the 2011 fiscal year, CarMax recorded $4.1 billion of finance receivables and $3.7 billion of non-recourse notes payable. There was only a modest net impact on shareholders' equity, as this was merely an accounting entry. The company's recourse debt remains unsubstantial, represented by a net debt-to-equity ratio of 3.7%. This is a demonstration of the use of available free cash flow rather than debt to fund the company's expansion.

Valuation

The Classic Valuation Pattern of a Growth Company
CarMax has been viewed as a specialty retailer since its inception. Most retail companies are characterized by a beginning period of rapid sales growth that is accompanied by a high valuation, but then followed by a natural decline in the growth rate due to a saturation of the intended consumer market. During the growth phase, the stock is entertained by growth investors who are willing to pay a substantial valuation premium, yet eschewed by those of the value orientation. The class of investors generally is reversed as the company matures.

The oddity of CarMax is that it appears the company is still solidly in its growth phase, but growth investors have abandoned the company's prospects. In other words, the risk premium has risen considerably from just a few years ago during which the p/e ratio was well in excess of 20x. Interestingly, the valuation predicament the company finds itself in presently is not without precedent. During the 2001-2002 recession, the company traded at roughly 11x earnings. As shown in the table below, following this cyclical compression of equity valuations, the CarMax p/e ratio rose to a more growth-oriented range of 20x-30x earnings. It cannot be responsibly implied that the economic recovery now underway will produce similar valuation results; however, some degree of expansion in the valuation multiple, if as a function of nothing other than a natural diminution of equity market risk premiums, is not an unreasonable position.

Table 6: Historical CarMax P/E Ratio

Fiscal Year	P/E
2011 est	13.8x
2010	16.0x
2009	34.9x
2008	22.4x
2007	29.0x
2006	24.9x
2005	34.4x
2004	30.9x
2003	16.5x
2002	30.7x
2001	11.7x

Comparative Dealership Statistics

In general, the dealership companies trade at valuations that reflect the rather dire circumstances of the automobile industry of several months ago. This is historically inconsistent with the valuation pattern of cyclical companies, which will normally receive high valuations during cyclically low earnings periods, in the anticipation of a recovery scenario. Nevertheless, the valuation range is roughly 8x-14x earnings, as presented in the following table. As well, given the inherent volatility of industry earnings, the enterprise value-to-sales measure demonstrates a range of 0.2x-0.8x.

Table 7: Auto Dealership Industry Valuations

Company	2010 P/E	EV/Sales (3)
CarMax (1)	13.9x	0.5x
AutoNation	13.6x	0.3x
Penske Automotive Group	9.9x	0.2x
Group 1 Automotive	9.8x	0.2x
Lithia Motors	9.0x	0.2x
Sonic Automotive	9.0x	0.2x
America's Car-Mart (2)	8.5x	0.8x
Asbury Automotive Group	8.5x	0.2x

(1) Based on a February 2011 FY
(2) Based on an April 2011 FY
(3) Debt excludes floor plan financing, or non-recourse loans

The reader will clearly notice the distinctive premium at which CarMax and AutoNation trade in relation to the majority of these companies. By far, AutoNation is the largest U.S. dealership, with 246 franchises, and has proven to be the most adept at acquiring and successfully integrating its acquisitions. Penske, which operates mostly import brand dealerships, owns 158 franchises, and is the second largest within the industry. It is important to note that Penske, along with many other smaller dealership companies listed in the above table, employ rather leveraged balance sheets. Evidently, the market is concerned that continued weakness, or a further deterioration in U.S. automobile sales, will impair the ability of these companies to service their rather high debt loads, a sentiment that is clearly magnified in the post-Credit Crisis period.

CarMax is not nearly as large as AutoNation, but it has very little exposure to the new vehicle industry, which has provided a hedge against the sharp decline U.S. new auto sales. On average, most of the companies presented in the table above derive 70%-75% of their revenues from new vehicle sales, which caused a marked earnings disruption over the past few years. One can therefore reason that the CarMax valuation premium is due in part to the company's focus on the used vehicle market, which has proven more resilient during the recent recession.

Noted earlier was the rather unique example of America's Car-Mart. Although somewhat counterintuitive, it produces superior profitability by focusing on the lower end and less than creditworthy consumer. Companies such as this, while uncommon, are similar in one respect. That is, by serving a market that most others will not, there is generally an unusual opportunity to dominate a certain niche. America's Car-Mart is far from a national brand or franchise, but nevertheless operates quite successfully on a smaller scale at the moment.

Apart from this example, on a profitability basis, the premium CarMax valuation is also reasonably explained by its profit features. In the coming fiscal year, it is anticipated to generate a 3.9% net margin, which is roughly 4x the estimated profitability of smaller dealership companies.

Table 8: Industry Net Profitability Comparison

Company	2010E Net Margin
CarMax (1)	3.9%
AutoNation	2.0%
Penske Automotive Group	1.0%
Group 1 Automotive	1.1%
Lithia Motors	0.9%
Sonic Automotive	0.7%
America's Car-Mart (2)	8.3%
Asbury Automotive Group	1.0%

(1) Based on a February 2011 FY
(2) Based on an April 2011 FY

A Reasonable Return Outcome

While the so-called premium valuation has been demonstrated, it is important to place this within the context of the equity market. The CarMax 13.9x p/e ratio may well be a premium to smaller, more competitively challenged dealerships, but it is not a high valuation more broadly, nor is it reflective of the company's expansion opportunities.

Following a retrenchment in store growth during the recent recession, CarMax intends to open 3 stores in the current fiscal year, 3-5 locations in 2012, and 5-10 dealerships in 2013. This programmed and rather measured pace of expansion results in 14.5% store growth, at the mid-point, over the next three years, and 18% at the high end of these estimates. This obviously will produce an increase in revenues to some degree over the near term.

Consideration should also be given to the potential improvement in U.S. auto sales from the current low level of 11.1 million units annually. As recent as in 2004, annual new vehicle sales were 52% higher, at 16.9 million units. While the volume impact would only benefit CarMax slightly, given its low exposure to new vehicle franchises, the overall pricing environment for automobiles should improve in this scenario, which would create margin opportunities even in the used vehicle market.

Most importantly, over a longer period of time, one cannot dismiss the insignificant 2% market share of CarMax presently. There will inevitably be a limit to the number of locations that may be opened and, at some point, perhaps several years hence, CarMax may well be compelled to undertake acquisitions. In theory, though, 98% of the market is mostly unconsolidated, which potentially presents a truly remarkable expansion path well into the future.

While the current state of the used vehicle industry represents a variety of opportunities from a revenue perspective, CarMax has also been improving its profitability level, undoubtedly a result of increased operational scale. It is difficult to simulate with precision a future margin level for the company, because the ultimate benefits of expansion and consolidation are not yet known. With each passing year, the margins of the large auto dealerships are increasing, such that there is no verifiable measure as to the limit of this progress. Arbitrarily, yet also employing realistic historical growth patterns, the reader could assume the CarMax net margin a few years hence to be in the 4.5%-5% range. On an absolute basis, this would be a modest achievement; yet, relative to the current 3.9% level, the increase would be 15%-28%, and this would be applied to a higher sales base.

In short, one could apply rather conservative versions of these growth scenarios and arrive at a reasonable longer term growth rate, perhaps in the double digit range. At the moment, one is not required to pay an unrealistic price for such visibility.

Investment Summary

CarMax is the largest used vehicle retail firm in the United States. The company has grown rapidly over the course of the past decade through the expansion of its "superstore" format. It has conservatively funded this growth not by borrowing heavily, but through the use of its available cash flow. By most measures, it is one of the more well-managed auto dealership franchises in the nation. However, the cyclical manifestations of the auto industry caused a disruption to the company's growth progress, and the valuation subsequently collapsed. Yet, the current price dismisses salient dimensions of the auto retail market over the longer term, most notably the ongoing consolidation and margin expansion. In light of the fact that CarMax, despite being the largest used retailer, maintains merely 2% market share, the growth possibilities could endure for several years. However, one can buy this presumed earnings visibility at a cyclically low valuation. Therefore, the shares are recommended for purchase.

CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands except per share data)	2010	2009	2008
SALES AND OPERATING REVENUES:			
Used vehicle sales	$6,192,278	$5,690,658	$6,589,342
New vehicle sales	186,481	261,940	370,603
Wholesale vehicle sales	844,868	779,785	985,048
Other sales and revenues	246,566	241,583	254,578
NET SALES AND OPERATING REVENUES	7,470,193	6,973,966	8,199,571
Cost of sales	6,371,323	6,005,796	7,127,146
GROSS PROFIT	1,098,870	968,170	1,072,425
CARMAX AUTO FINANCE INCOME	175,217	15,286	85,865
Selling, general and administrative expenses	818,691	882,358	858,372
Gain on franchise disposition	—	—	740
Interest expense	3,460	6,086	4,955
Interest income	560	1,786	1,366
Earnings before income taxes	452,496	96,798	297,069
Income tax provision	170,828	37,585	115,044
NET EARNINGS	$ 281,668	$ 59,213	$ 182,025
Weighted average common shares:*(2)*			
Basic	219,527	217,537	216,045
Diluted	222,234	219,357	219,963
NET EARNINGS PER SHARE:*(2)*			
Basic	$ 1.27	$ 0.27	$ 0.84
Diluted	$ 1.26	$ 0.27	$ 0.82

CONSOLIDATED BALANCE SHEETS

(In thousands except share data)	As of February 28 2010	2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 18,278	$ 140,597
Accounts receivable, net	99,434	75,876
Auto loan receivables held for sale	30,578	9,748
Retained interest in securitized receivables	552,377	348,262
Inventory	843,133	703,157
Deferred tax asset	5,595	—
Prepaid expenses and other current assets	7,017	10,112
TOTAL CURRENT ASSETS	1,556,412	1,287,752
Property and equipment, net	893,453	938,259
Deferred income taxes	57,234	103,163
Other assets	49,092	50,013
TOTAL ASSETS	$2,556,191	$2,379,187
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 253,267	$ 237,312
Accrued expenses and other current liabilities	94,557	55,793
Accrued income taxes	6,327	26,551
Deferred income taxes	—	12,129
Short-term debt	883	878
Current portion of long-term debt	122,317	158,107
TOTAL CURRENT LIABILITIES	477,351	490,770
Long-term debt, excluding current portion	27,371	178,062
Deferred revenue and other liabilities	117,887	117,288
TOTAL LIABILITIES	622,609	786,120
Commitments and contingent liabilities		
SHAREHOLDERS' EQUITY:		
Common stock, $0.50 par value; 350,000,000 shares authorized; 223,065,542 and 220,392,014 shares issued and outstanding as of February 28, 2010 and 2009, respectively	111,533	110,196
Capital in excess of par value	746,134	685,938
Accumulated other comprehensive loss	(19,546)	(16,860)
Retained earnings	1,095,461	813,793
TOTAL SHAREHOLDERS' EQUITY	1,933,582	1,593,067
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$2,556,191	$2,379,187