EnergySolutions, Inc.
Form 10-Q
May 08, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009

Or

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

For the transition period from to

Commission file number 001-33830

Energy*Solutions*, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**51-0653027**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
423 West 300 South, Suite 200 **Salt Lake City, Utah** (Address of principal executive offices)	**84101** (Zip Code)

Registrant's telephone number, including area code: **(801) 649-2000**

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 ý No o

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 o No o

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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of April 30, 2009, 88,305,674 shares of registrant's common stock were outstanding.

ENERGY*SOLUTIONS*, INC.

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For the Three Months Ended March 31, 2009

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PART I

Item 1. Financial Statements

Energy*Solutions*, Inc.

Condensed Consolidated Balance Sheets

March 31, 2009 and December 31, 2008

(in thousands of dollars)

	March 31, 2009 (unaudited)	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 30,933	$ 48,448
Accounts receivable, net of allowance for doubtful accounts	321,507	213,037
Costs and estimated earnings in excess of billings on uncompleted contracts	68,027	59,545
Income tax receivable	5,592	5,537
Inventories	12,230	11,218
Prepaid expenses	17,528	19,109
Other current assets	21,127	34,363
Total current assets	476,944	391,257
Property, plant and equipment, net	113,558	114,021
Goodwill	528,254	528,254
Other intangible assets, net	350,519	357,100
Restricted cash and decontamination and decommissioning deposits	30,092	31,712
Other noncurrent assets	136,854	128,368
Total assets	$ 1,636,221	$ 1,550,712
Liabilities and Equity		
Current liabilities:		
Current portion of long-term debt	$ 3,213	$ 2,954
Accounts payable	115,312	89,513
Accrued expenses and other current liabilities	225,898	177,439
Deferred income taxes	2,068	2,067
Unearned revenues	28,989	26,734
Total current liabilities	375,480	298,707
Long-term debt, less current portion	553,544	563,803
Pension liability	115,648	104,897
Facility and equipment decontamination and decommissioning liabilities	64,648	65,904
Deferred income taxes	41,658	41,385
Other noncurrent liabilities	4,746	7,197
Total liabilities	1,155,724	1,081,893

Commitments and contingencies		
Energy*Solutions* stockholders' equity:		
Preferred stock, $0.01 par value, 100,000,000 shares authorized; no shares issued and outstanding		
Common stock, $0.01 par value, 1,000,000,000 shares authorized; 88,305,674 shares issued and outstanding	883	883
Additional paid-in capital	482,562	482,042
Accumulated other comprehensive income	7,958	4,895
Capital deficiency	(11,897)	(20,034)
Total Energy*Solutions* stockholders' equity	479,506	467,786
Noncontrolling interests	991	1,033
Total equity	480,497	468,819
Total liabilities and equity	$ 1,636,221	$ 1,550,712

See accompanying notes to condensed consolidated financial statements.

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Energy*Solutions*, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Income

Three Months Ended March 31, 2009 and 2008

(in thousands of dollars, except per share information)
(Unaudited)

	Three Months Ended March 31,			
		2009		2008
Revenues	$	437,109	$	501,753
Cost of revenues		386,511		428,220
Gross profit		50,598		73,533
Selling, general and administrative expenses		30,779		28,262
Income from operations		19,819		45,271
Interest expense		(7,956)		(12,538)
Other income (expenses), net		733		(2,061)
Income before income taxes and noncontrolling interests		12,596		30,672
Income tax expense		(4,274)		(11,184)
Net income		8,322		19,488
Less: Net income attributable to noncontrolling interests		(195)		(195)
Net income attributable to Energy*Solutions*	$	8,127	$	19,293
Net income attributable to Energy*Solutions* per share see note 8:				
Basic	$	0.09	$	0.22
Diluted	$	0.09	$	0.22
Shares used to calculate net income attributable to Energy*Solutions* per share:				
Basic		88,305,674		88,303,500
Diluted		88,337,242		88,310,022
Cash dividends declared per common share	$	0.025	$	0.025
Comprehensive income:				
Net income	$	8,322	$	19,488
Foreign currency translation adjustment		965		204
Change in unrecognized actuarial gain (loss)		2,098		(2,113)
Comprehensive income		11,385		17,579
Comprehensive income attributable to noncontrolling interests		(195)		(195)
Comprehensive income attributable to Energy*Solutions*	$	11,190	$	17,384

See accompanying notes to condensed consolidated financial statements.

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Energy*Solutions*, Inc.

Condensed Consolidated Statements of Cash Flows

Three Months Ended March 31, 2009 and 2008

(in thousands of dollars)
(Unaudited)

	Three Months Ended March 31,	
	2009	**2008**
Cash flows from operating activities		
Net income attributable to Energy*Solutions*	$ 8,127	$ 19,293
Adjustments to reconcile net income attributable to Energy*Solutions* to net cash provided by operating activities:		
Net income attributable to noncontrolling interests	195	195
Depreciation and amortization	11,651	11,818
Equity-based compensation expense	2,727	2,551
Foreign currency transaction loss	762	475
Deferred income taxes	2,307	1,229
Amortization of debt financing fees	1,033	717
Loss on disposal of property, plant and equipment	1	124
Unrealized (gain) loss on derivative contracts	(38)	2,842
Changes in operating assets and liabilities:		
Accounts receivable	(111,936)	(3,244)
Costs and estimated earnings in excess of billings on uncompleted contracts	(8,483)	(33,497)
Income tax receivable	(55)	6,131
Inventories	(1,011)	(903)
Prepaid expenses and other current assets	17,248	(7,722)
Accounts payable	27,375	(17,882)
Accrued expenses and other current liabilities	57,255	32,885
Unearned revenues	(4,110)	7,051
Facility and equipment decontamination and decommissioning liabilities	369	393
Restricted cash and decontamination and decommissioning deposits	(6)	2,248
Other noncurrent assets	(11,662)	(11,982)
Other noncurrent liabilities	9,883	13,417
Net cash provided by operating activities	1,632	26,139
Cash flows from investing activities		
Purchases of property, plant and equipment	(4,195)	(1,280)
Purchases of intangible assets	(372)	
Net cash used in investing activities	(4,567)	(1,280)
Cash flows from financing activities		
Repayments of long-term debt	(10,000)	(20,000)
Dividends to stockholders	(2,208)	(2,208)
Distributions to noncontrolling interests partners	(228)	(131)
Repayments of capital lease obligations	(353)	(396)
Net cash used in financing activities	(12,789)	(22,735)
Effect of exchange rate on cash		

	(1,791)	(404)
Net increase (decrease) in cash and cash equivalents	(17,515)	1,720
Cash and cash equivalents, beginning of period	48,448	36,366
Cash and cash equivalents, end of period	$ 30,933	$ 38,086

See accompanying notes to condensed consolidated financial statements.

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(1) Description of Business

Energy*Solutions*, Inc. ("we," "our," "Energy*Solutions*" or the "Company") is a leading provider of specialized, technology-based nuclear services to government and commercial customers. Our customers rely on our expertise to address their needs throughout the lifecycle of their nuclear operations. Our broad range of nuclear services includes engineering, operation of nuclear reactors, in-plant support services, spent nuclear fuel management, decontamination and decommissioning ("D&D"), logistics, transportation, processing and disposal. We derive almost 100% of our revenues from the provision of nuclear services.

We provide our services through four segments: Federal Services; Commercial Services; Logistics, Processing and Disposal ("LP&D"), and International. Our Federal Services segment derives revenues from U.S. government customers for the management and operation or clean-up of facilities with radioactive materials. Our U.S. government customers are primarily individual offices, departments and administrations within the U.S. Department of Energy ("DOE") and U.S. Department of Defense ("DOD"). Our Commercial Services segment provides a broad range of on-site services, including D&D, to commercial customers. Our commercial customers include power and utility companies, pharmaceutical companies, research laboratories, universities, industrial facilities and other commercial entities with nuclear materials, as well as state agencies in the United States. Our LP&D segment provides a broad range of logistics, transportation, processing and disposal services to government and commercial customers. This segment also operates our facilities for the safe processing and disposal of radioactive materials, including a facility in Clive, Utah, four facilities in Tennessee and two facilities in Barnwell, South Carolina. Our International segment derives revenues primarily through contracts with the Nuclear Decommissioning Authority ("NDA") in the United Kingdom ("UK") to operate, manage and decommission 10 Magnox sites with 22 nuclear reactors. In addition, our International segment provides turn-key services for the disposal of radioactive sources from non-nuclear power generating facilities such as hospitals, research facilities and other manufacturing and industrial facilities.

(2) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring activities, considered necessary for a fair presentation have been included. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission on February 27, 2009.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of results that can be expected for the full year.

Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(2) Basis of Presentation (Continued)

We have majority voting rights for two of our minority-owned joint ventures. Accordingly, we have consolidated their operations in our consolidated financial statements. We recorded the noncontrolling interests, which reflects the portion of the earnings of operations which are applicable to other noncontrolling partners.

Certain amounts for prior periods have been reclassified to conform to the current year presentation. Prior to the fourth quarter of 2008, we included letter of credit interest in cost of revenues and selling, general and administrative expenses. During the fourth quarter of 2008, we reclassified these amounts from operating expenses to interest expense in the accompanying condensed consolidated statements of operations. Accordingly, for the three months ended March 31, 2008, gross profit and income from operations were increased by $550,000 and $878,000, respectively, as a result of this reclassification. We have also reclassified $6.4 million from unearned revenues to accrued expenses and other current liabilities to conform to the current year presentation.

(3) Recent Accounting Pronouncements

Accounting Pronouncements Recently Adopted

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. SFAS No. 160 requires that noncontrolling (or minority) interests in subsidiaries be reported in the equity section of a company's balance sheet, rather than in a mezzanine section of the balance sheet between liabilities and equity. SFAS No. 160 also changes the manner in which the net income of a subsidiary is reported and disclosed in the controlling company's income statement. SFAS No. 160 also establishes guidelines for accounting for changes in ownership percentages and for deconsolidation. Pursuant to the transition provisions of SFAS No. 160, we adopted the statement on January 1, 2009 via retrospective application of the presentation and disclosure requirements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Pursuant to the transition provisions of the statement, we adopted SFAS No. 161 on January 1, 2009. The required disclosures are presented in Note 7 on a prospective basis. SFAS No. 161 does not impact the consolidated financial results as it is disclosure-only in nature.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) replaces SFAS No. 141, *Business Combinations*, but retains the requirement that the purchase method of accounting for acquisitions be used for all business combinations. SFAS No. 141(R) expands on the disclosures previously required by SFAS No. 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 No. 141(R) also requires an acquirer to record an adjustment to income tax expense for changes

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(3) Recent Accounting Pronouncements (Continued)

in valuation allowances or uncertain tax positions related to acquired businesses. Pursuant to the transition provisions of the statement, we adopted SFAS No. 141(R) on January 1, 2009 and it does not impact the consolidated financial results as we had no acquisitions during the three months ended March 31, 2009.

Accounting Pronouncements Issued But Not Yet Effective

In April 2009, the FASB issued three new FASB Staff Positions (FSPs) all of which impact the accounting and disclosure related to certain financial instruments. FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" (FSP FAS 157-4) provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. It also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 115-2 and FAS 124-2, "Recognition of Other-Than-Temporary Impairment" (FSP FAS 115-2 and FAS 124-2) amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP FAS 107-1 and APB 28-1 "Interim Disclosures about Fair Value of Financial Instruments" (FSP FAS 107-1 and APB 28-1) amends FASB Statement No. 107 to require disclosures about the fair value of financial instruments on an interim basis in addition to the annual disclosure requirements. All three FSPs are required to be adopted for interim periods ending after June 15, 2009. We do not expect adoption of these staff positions to have a material impact on our financial position, results of operations or cash flows.

(4) Inventories

Inventories consist of the following as of March 31, 2009 and December 31, 2008:

	March 31, 2009	December 31, 2008
	(in thousands of dollars)	
Parts and supplies	$ 407	$ 517
Work in process		3,050
Finished goods	11,823	7,651
	$12,230	$ 11,218

(5) Senior Credit Facilities

Our credit facilities consist of a $75.0 million revolving credit facility, which matures on June 7, 2011, and a total of $770.0 million in term loan facilities, which mature on June 7, 2013, and a $100.0 million synthetic letter of credit facility, which expires on June 7, 2013. The revolving credit facility includes a sublimit of $60.0 million for letters of credit, of which $14.9 million were issued as of March 31, 2009. The synthetic letter of credit facility had $100.0 million issued as of March 31, 2009.

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(5) Senior Credit Facilities (Continued)

Borrowings under the credit facilities bear interest at a base rate (the greater of the Prime Rate or 0.5% higher than the Federal Funds Rate) plus an applicable margin or, at our option, the London Interbank Offered Rates ("LIBOR"), adjusted for the Eurodollar reserve percentage, plus an applicable margin. The applicable margin for base rate and LIBOR loans is 2.25%. As of March 31, 2009 and 2008, the interest rate of borrowings under the term loan facilities was 4.15% and 7.1%, respectively.

According to the terms of the credit agreements, at the end of each calendar quarter, we are required to make scheduled repayments of the term loans of $1.5 million, adjusted for optional prepayments made. In addition to the scheduled repayments, we may be required to make mandatory quarterly repayments, to be applied to the principal balance of the term loan, the amounts of which are dependent on our excess cash flow for the quarter and our leverage ratio as defined in the credit agreements. As of March 31, 2009, we have mandatory principal repayments based on our excess cash flow and scheduled repayments of $3.2 million due within the next 12 months. The outstanding principal of the term loan facilities must be repaid by June 7, 2013.

The credit facilities require us to maintain certain financial ratios, including maximum leverage ratios (based upon the ratios of total consolidated indebtedness and first lien indebtedness to consolidated operating cash flow) and a minimum cash interest coverage ratio (based upon the ratio of consolidated operating cash flow to consolidated cash interest expense), which are tested quarterly. Based on the formulas set forth in the credit agreements as of March 31, 2009, we are required to maintain a maximum leverage ratio and a maximum first lien leverage ratio of 4.25 and 3.75, respectively, and minimum cash interest coverage ratio of 2.50. Failure to comply with these financial ratio covenants would result in a default under our credit facilities and, absent a waiver or an amendment from the lenders, preclude us from making further borrowings under our credit facilities and permit the lenders to accelerate all outstanding borrowings under the credit facilities. As of March 31, 2009, our total leverage, first lien leverage and interest coverage ratios were 3.36, 3.36 and 5.18, respectively. The credit agreements also contain annual capital expenditure limitations. For fiscal year 2009, the credit agreements require us to limit capital expenditures to $45.0 million. Capital expenditures for the three months ended March 31, 2009 were $4.2 million. As of March 31, 2009, we were in compliance with all of the covenants under our credit agreements.

The obligations under the credit facilities are secured by substantially all of our assets and guaranteed by each of our existing and subsequently acquired or organized domestic subsidiaries.

During the three months ended March 31, 2009 and 2008, we made principal repayments totaling $10.0 million and $20.0 million, respectively, on the outstanding term loan facilities. During the three months ended March 31, 2009 and 2008, we made cash interest payments of $876,000 and $11.8 million, respectively.

Amendment Agreements

On December 11, 2007, we, through our subsidiary ZionSolutions, entered into an agreement with Exelon (the "Zion Agreement") to dismantle Exelon's Zion nuclear facility located in Zion, Illinois ("Zion Station"), which ceased operation in 1998.

Upon completion of the transaction, Exelon has agreed to transfer to ZionSolutions substantially all of the assets (other than land) associated with Zion Station, including assets held in nuclear

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(5) Senior Credit Facilities (Continued)

decommissioning trusts. In consideration for Exelon's transfer of those assets, ZionSolutions has agreed to assume decommissioning and other liabilities associated with the Zion Station. ZionSolutions also agreed to take possession and control of the land associated with the Zion Station pursuant to a lease agreement to be executed at the closing. ZionSolutions will be obligated to complete the required decommissioning work according to an established schedule and to construct a dry cask storage facility on the land for spent nuclear fuel currently held in spent fuel pools at the Zion Station.

The parties agreed to enter into various other agreements to ensure the performance of the obligations of ZionSolutions under its contracts to complete the required decommissioning and other work. In particular, we have agreed to execute a Credit Support Agreement pursuant to which we will deliver a letter of credit in the face amount of $200.0 million, which will be held by Exelon. The occurrence of specified events of default would allow Exelon to draw upon the letter of credit.

In anticipation of the closing of this transaction, on July 16, 2008, we and our subsidiary, Duratek, Inc. ("Duratek"), entered into Amendment Agreements with our lenders under the current credit facilities. The Amendment Agreements provide that the existing credit agreements shall be amended and restated in their entirety upon satisfaction of certain conditions including the closing of the transaction with Exelon.

The amended and restated credit facilities were sought (a) to allow us to provide for a new letter of credit facility in the aggregate principal amount of $200.0 million (the "Zion letter of credit facility") pursuant to the Zion Agreement and (b) to return the existing synthetic letters of credit facility deposits and make term letter of credit facility loans in the aggregate principal amount of $100.0 million for which we have agreed to maintain restricted cash equal to the amount of the facility. The new term letter of credit facility and the restricted cash amount will be reflected on our consolidated balance sheet when they are effective concurrent with completing the transaction with Exelon.

The Amendment Agreements provide that the amended and restated credit facilities will include letter of credit fees of 2.50% with respect to letters of credit issued under each of the revolving loan facility and the Zion letter of credit facility. In addition, the Amendment Agreements provide that the amended and restated credit facilities will provide for interest rates on loans as follows: (i) with respect to any term loan, (x) LIBOR plus 2.50% (or LIBOR plus 2.00% when the leverage ratio is less than 2.0 to 1.0) or (y) the base rate plus 1.25% (or the base rate plus 1.00% when the leverage ratio is less than 2.0 to 1.0), (ii) with respect to any revolving loan, (x) LIBOR plus 2.50% or (y) the base rate plus 1.25%, and (iii) with respect to any term letter of credit facility loan, LIBOR plus 2.50% (or LIBOR plus 2.00% when the leverage ratio is less than 2.0 to 1.0).

The Amendment Agreements provide that the amended and restated credit facilities are subject to the satisfaction of certain conditions precedent to closing, including those related to approval for the transactions contemplated by the Zion Agreement. In July 2008, we paid fees of approximately $6.4 million to the lenders to obtain the Amendment Agreements, which are being amortized over the remaining term of the credit facilities. In addition, once we have closed the Zion agreement and the Zion letter of credit is issued, we anticipate paying the providers of the Zion letter of credit facility approximately $7.5 million, which will be amortized over one year, which is the term of the Zion letter of credit facility.

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(6) Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that a company has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 14, 2007. In February 2008, the FASB issued FASB Staff Position ("FSP") FAS 157-2, *Partial Deferral of the Effective Date of Statement 157*, which delays the effective date for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The FSP deferred the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. In accordance with this staff position, we adopted the provisions of SFAS No. 157 that became effective at the beginning of fiscal year 2008 with respect to financial assets and liabilities, which did not have an impact on our financial position, results of operations or cash flows. We adopted the provisions of SFAS No. 157 for non-financial assets and liabilities in the first quarter of 2009, which did not have a material impact on our financial position, results of operations or cash flows.

The carrying value of accounts receivable, inventories, prepaid assets, accounts payable, accrued expenses and unearned revenues approximate their fair value principally because of the short-term nature of these assets and liabilities. As of March 31, 2009 and December 31, 2008, we had outstanding term loans of $556.8 million and $566.8 million with fair values of approximately $490.0 million and $430.7 million, respectively.

As of March 31, 2009 and December 31, 2008, we had no assets or liabilities considered to be Level 1 or Level 3. The following table discloses the Level 2 fair value of our interest rate and foreign currency derivative contracts outstanding at March 31, 2009 and December 31, 2008 that are included in other current assets, accrued expenses and other current liabilities and other noncurrent liabilities in the accompanying balance sheets:

		March 31, 2009 (in thousands of dollars)	December 31, 2008 (in thousands of dollars)
Assets			
Fair value of derivative contracts	short term	$ 158	$
Liabilities			
Fair value of derivative contracts	short term		521
Fair value of derivative contracts	long term	902	261

(7) Derivative Financial Instruments

We have entered into derivative contracts to help offset our exposure to movements in interest rates in relation to our variable rate debt. As of March 31, 2009 and December 31, 2008, the fair value liability of the derivative contracts was $902,000 and $261,000, respectively, which is included in other

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(7) Derivative Financial Instruments (Continued)

noncurrent liabilities in the accompanying balance sheets. These contracts are not designated as accounting hedges. Unrealized gains and losses resulting from adjustments to the fair value of the contracts are included in other income (expenses), net, and resulted in a net loss of $641,000 and $2.8 million for the three months ended March 31, 2009 and 2008, respectively. We do not use interest rate derivatives for trading or speculative purposes.

We have foreign currency exposure related to our operations in the UK as well as other foreign locations. During the three months ended March 31, 2009 and 2008, we recognized losses of $1.0 million and $817,000, respectively, in other income (expenses) net, in the accompanying consolidated statements of operations related to foreign currency gains or losses. We have entered into derivative contracts to help offset our exposure to movements in foreign currency rates in relation to our U.S. dollar denominated intercompany loan with our UK subsidiary. This foreign currency derivative contract is not designated as an accounting hedge. As of March 31, 2009, the fair value of the derivative was $158,000, which is included in other current assets in the accompanying balance sheets. Unrealized gains and losses resulting from adjustments to the fair value of the contracts are included in other income (expenses), net and resulted in a gain of $680,000 for the three months ended March 31, 2009. We had no foreign currency derivative contracts for the three months ended March 31, 2008.

(8) Net Income Per Share

Basic net income per share is computed by dividing net income attributable to Energy*Solutions* by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income attributable to Energy*Solutions* by the weighted-average number of common shares outstanding during the period and potentially dilutive common stock equivalents. Potential common stock equivalents that have been issued by us relate to outstanding stock option and non-vested restricted stock awards and are determined using the treasury stock method.

The following table sets forth the computation of the common shares outstanding in determining basic and diluted net income per share:

	For the Three Months Ended March 31,	
	2009	2008
Weighted average common shares basic	88,305,674	88,303,500
Potential common stock from restricted stock and stock options	31,568	6,522
Weighted average common shares diluted	88,337,242	88,310,022

For the three months ended March 31, 2009 and 2008, respectively, there were 7.5 million and 5.8 million potentially dilutive securities excluded from the diluted net income per share calculation as they were anti-dilutive.

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(9) Equity-Based Compensation

Profit Interests

In prior years, certain members of our management were granted profit interest units in ENV Holdings LLC ("ENV Holdings"), formerly our parent, in consideration for services rendered during the vesting period. These units did not represent ownership in ENV Holdings but rather these units entitled the holders to distributions from ENV Holdings if a distribution was paid. There were several classes of units granted and each successive class carried a lower priority on distributions. Certain units vested immediately upon grant and others vested over periods up to three years. We estimated the fair value at grant date of the units issued using both a market and an income approach and recorded compensation expense of $308,000 and $281,000 for the three months ended March 31, 2009 and 2008, respectively, which represents the portion of the fair value of these units that vested in those periods. In February 2009, ENV Holdings liquidated and made a final distribution to its members at which time any unvested units vested and as of March 31, 2009, there was no unrecognized compensation expense related to the profit interest units.

Stock Options and Restricted Stock

In November 2007, we adopted the Energy*Solutions*, Inc. 2007 Equity Incentive Plan (the "Plan"). The Plan authorizes our Board of Directors to grant equity awards to directors, officers, employees and consultants. The aggregate number of shares of common stock that may be issued pursuant to awards granted under the Plan is 10,440,000. We recorded non-cash compensation expense related to our stock option and restricted stock grants of $2.4 million and $2.3 million during the three months ended March 31, 2009 and 2008, respectively. As of March 31, 2009, we had $25.9 million of unrecognized compensation expense related to outstanding stock options, which will be recognized over a weighted-average period of 2.8 years. As of March 31, 2009, there was $3.0 million of unrecognized compensation cost related to non-vested restricted stock which is expected to be recognized over a weighted-average period of 3.2 years.

(10) Pension Plans

Net periodic benefit costs for the three months ended March 31, 2009 and 2008 consisted of the following:

	For the Three Months Ended March 31,	
	2009	2008
	(in thousands of dollars)	
Service cost	$ 7,766	$ 12,661
Interest cost	34,478	46,686
Expected return on plan assets	(29,122)	(52,027)
	$ 13,122	$ 7,320

The preceding information does not include amounts related to benefit plans applicable to employees associated with certain contracts with the U.S. Department of Energy because we are not responsible for the current or future funded status of these plans.

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(11) Income Taxes

We recognized income tax expense of $4.3 million and $11.2 million for the three months ended March 31, 2009 and 2008, respectively, based on an estimated annual effective tax rate on our consolidated operations of 34.5% and 36.6%, respectively. During the three months ended March 31, 2009 and 2008, we made income tax payments of $5.5 million and $3.4 million, respectively.

For the three months ended March 31, 2009 and 2008, we had no change in our unrecognized tax benefits under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109.* As of March 31, 2009 and December 31, 2008, we had $906,000 of unrecognized tax benefits, which may impact our annual effective tax rate in future years.

(12) Segment Reporting and Business Concentrations

We provide our services through four segments: Federal Services ("FS"), Commercial Services ("CS"), Logistics, Processing and Disposal ("LP&D"), and International. The following table presents segment information as of and for the three months ended March 31, 2009 and 2008:

	As of and for the Three Months Ended March 31, 2009					
	FS	CS	LP&D	International	Corporate Unallocated Items	Consolidated
	(in thousands of dollars)					
Revenues from external customers(1)	$ 66,081	$ 21,724	$ 46,004	$ 303,300	$	$ 437,109
Income (loss) from operations	5,615	3,178	11,763	18,509	(19,246)	19,819
Depreciation and amortization expense	224	361	5,413	2,376	3,277	11,651
Goodwill	143,514	90,129	233,193	61,418		528,254
Other long-lived assets(2)	34,579	21,129	227,621	94,707	86,041	464,077
Purchases of property, plant and equipment	3,517	202	(653)	22	1,107	4,195
Total assets(3)	283,664	149,436	558,115	461,658	183,348	1,636,221

	As of and for the Three Months Ended March 31, 2008					
	FS	CS	LP&D	International	Corporate Unallocated Items	Consolidated
	(in thousands of dollars)					
Revenues from external customers(1)	$ 44,587	$ 30,595	$ 54,115	$ 372,456	$	$ 501,753
Income (loss) from operations	6,348	9,644	16,894	30,105	(17,720)	45,271
Depreciation and amortization expense	107	499	5,387	2,344	3,481	11,818
Goodwill	143,144	91,042	232,713	59,178		526,077
Other long-lived assets(2)	31,809	27,290	248,915	103,728	72,962	484,704
Purchase of property, plant and equipment	25	171	367	128	589	1,280
Total assets(3)	247,532	164,438	586,103	521,199	145,832	1,665,104

(1)
Intersegment revenues have been eliminated for the three months ended March 31, 2009 and 2008. Intersegment revenues were $3.2 million for the three months ended March 31, 2009 and were not material for the three months ended March 31, 2008. Revenues by segment represent revenues earned based on third-party billing to customers.

(2)

Other long-lived assets include property, plant and equipment and other intangible assets.

(3)

Corporate unallocated assets relate primarily to income tax receivables, deferred tax assets, deferred financing costs, prepaid expenses, property, plant and equipment that benefit the entire company and cash.

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Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(13) Employee Termination Benefits

An organizational review of our Magnox sites identified an opportunity to reduce the existing workforce, primarily at three of the sites Dungeness, Sizewell and Chapelcross (the "Sites"). The Sites are in the process of defueling, which involves removing fuel from the reactor, loading it into flasks and transporting it for processing with a third party. The volume of fuel that can be processed is dependent on the third party reprocessing plant. Due to recent operational problems, the reprocessing plant has been, and will continue, struggling to handle the current volume of fuel from the Sites. As a result, defueling rates have decreased and fewer defueling staff are required at the Sites. In addition, decommissioning of the Magnox Berkeley site is relatively close to completion with only a few projects remaining. As such, activity at the Berkeley site is, and will continue for a number of years, to be very limited. Thus, the Berkeley site is overstaffed for the foreseeable future.

As a result of the overstaffing at the four Magnox sites, we presented a termination plan to the NDA to terminate approximately 200 employees on a voluntary basis at these sites. The termination plan and employee termination benefits to be paid for the voluntary termination of these employees in accordance with the Magnox Lifetime Plan, an agreement among Magnox, the employees and the trade unions, were pre-approved by the NDA Expenditure Review Panel during the three months ended March 31, 2009. All employee termination benefits are treated as part of the normal Magnox cost base and will be reimbursed by the NDA.

For the three months ended March 31, 2009, in accordance with SFAS No. 112, *Employers' Accounting for Postretirement Benefits*, we have recognized expected employee termination benefits of $31.6 million, which are included in cost of revenues in the accompanying condensed consolidated statements of operations for our International Segment. We have recognized a corresponding liability, which is included in accrued expenses and other current liabilities. In addition, we have recognized revenues and a receivable from the NDA for the reimbursement of the employee termination benefits. Benefits are expected to be paid over the next 18 months.

The following is a reconciliation of the beginning and ending liability balances (in thousands of dollars):

Beginning liability, December 31, 2008	$
Employee termination benefits	31,638
Payments	
Ending liability, March 31, 2009	$31,638

(14) Commitments and Contingencies

We may become subject to various claims and legal proceedings covering matters that may arise in the ordinary course of our business activities. As of March 31, 2009, we are not involved in any legal proceedings that we believe would have a material adverse effect on our consolidated financial position, operating results and cash flows.

Energy*Solutions*, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

(15) License Stewardship Program

On December 11, 2007, we, through our subsidiary ZionSolutions, entered into an agreement with Exelon to dismantle Exelon's Zion nuclear facility located in Zion, Illinois, which ceased operation in 1998. Upon completion of the transaction, Exelon has agreed to transfer to ZionSolutions substantially all of the assets (other than land) associated with Zion Station, including assets held in nuclear decommissioning trusts. In consideration for Exelon's transfer of those assets, ZionSolutions has agreed to assume decommissioning and other liabilities associated with the Zion Station. ZionSolutions also agreed to take possession and control of the land associated with the Zion Station pursuant to a lease agreement to be executed at the closing. ZionSolutions will be obligated to complete the required decommissioning work according to an established schedule and to construct a dry cask storage facility on the land for spent nuclear fuel currently held in spent fuel pools at the Zion Station. Closing of this transaction is subject to the satisfaction of a number of closing conditions, including approval by the NRC of the license transfer of the facility operating licenses and conforming license amendments from Exelon to ZionSolutions (the "License Transfer").

Due to the financial crisis that has impacted the United States and world markets, the Zion Station decommissioning trust fund balance, a significant portion of which is invested in the stock market, has declined. On October 14, 2008, we announced that we intend to defer the transfer of the Zion Station assets until we reaffirm that there is sufficient value in the Zion decommissioning trust funds to ensure adequate funds for the accelerated decommissioning of the plant. Pursuant to the agreement, we have until December 31, 2009 to close the transaction.

Prior to our announcement to defer the transfer of the Zion Station assets, we had anticipated that the closing of this transaction would occur in late third quarter or during the fourth quarter of 2008. Accordingly, we hired employees, entered into subcontracts and performed services for Exelon under a planning contract. Invoicing for some of these services provided is subject to the closing of the transaction. As of March 31, 2009 and December 31, 2008, we have incurred costs of $12.7 million and $12.4 million, respectively, which have been deferred until the closing of the transaction. Since we believe that the closing of this transaction before December 31, 2009 is still probable, we will continue to defer these costs until we close the transaction, at which time we will recognize the costs and related revenues. If we determine that it is not probable that we will close this transaction, we will expense these costs in the period of such determination. We have taken steps to reduce the monthly project costs including the termination of certain employees, transferring employees to other projects and the termination of certain subcontracts and lease agreements. Any costs relating to the termination of employees, subcontractors and lease or other agreements are expensed in the period terminated.

On May 4, 2009, the NRC issued an order approving the License Transfer subject to ZionSolutions satisfying the NRC that (i) the Zion letter of credit facility has been established, (ii) an irrevocable easement of disposal capacity of 7.5 million cubic feet has been established and (iii) the appropriate amount of insurance required of a licensee under the NRC's regulations has been obtained. If the License Transfer is not completed by May 4, 2010, the order approving the License Transfer expires; however, upon written application and for good cause shown, the expiration date may be extended by order of the NRC.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of the financial condition and results of our operations should be read together with the condensed consolidated financial statements and the related notes of EnergySolutions included elsewhere in this Form 10-Q.

Cautionary Statement Regarding Forward-Looking Statements

Certain statements made herein, including statements regarding our projected revenues, expenses and income and the implementation of strategic initiatives are forward-looking in nature. These forward-looking statements reflect current analysis of existing information and are subject to various risks and uncertainties. As a result, caution must be exercised in relying on forward-looking statements. Due to known and unknown risks, our actual results may differ materially from our expectations or projections.

While most risks affect only future revenues or expenses, some risks may relate to accruals that have already been reflected in earnings. Our failure to receive payments of accrued amounts or incurrence of liabilities in excess of amounts previously recognized could result in a charge against future earnings.

Additional information concerning these and other factors can be found in our periodic filings with the Securities and Exchange Commission (the "SEC"), including our Form 10-K filed February 27, 2009 and this report under "Item 1A Risk Factors." Our SEC filings are available publicly on the SEC's website at *www.sec.gov*, on Energy*Solutions'* website at *www.energysolutions.com* or upon request from Energy*Solutions'* Investor Relations Department at *ir@energysolutions.com*. We disclaim any obligation to update the forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We are a leading provider of specialized, technology-based nuclear services to government and commercial customers. Our customers rely on our expertise to address their needs throughout the lifecycle of their nuclear operations. Our broad range of nuclear services includes engineering, operation of nuclear reactors, in-plant support services, spent nuclear fuel management, decontamination and decommissioning ("D&D"), logistics, transportation, processing and disposal. We derive almost 100% of our revenues from the provision of nuclear services.

We provide our services through four segments: Federal Services, Commercial Services, Logistics, Processing and Disposal ("LP&D") and International. Our Federal Services segment derives revenues from U.S. government customers for the management and operation or clean-up of facilities with radioactive materials. Our U.S. government customers are primarily individual offices, departments and administrations within the U.S. Department of Energy ("DOE") and the U.S. Department of Defense ("DOD"). Our Commercial Services segment provides a broad range of on-site services, including D&D, to commercial customers. Our commercial customers include power and utility companies, pharmaceutical companies, research laboratories, universities, industrial facilities and other commercial entities with nuclear materials, as well as state agencies in the United States. Our LP&D segment provides a broad range of logistics, transportation, processing and disposal services to government and commercial customers. This segment also operates our facilities for the safe processing and disposal of radioactive materials, including a facility in Clive, Utah, four facilities in Tennessee and two facilities in Barnwell, South Carolina. In cases where a project involves the provision of both specialized nuclear services and processing and disposal services, our Federal Services or Commercial Services segment, depending on the type of customer, and our LP&D segment will coordinate to provide integrated services. Our International segment has contracts with the Nuclear Decommissioning Authority ("NDA") in the United Kingdom ("UK") to operate, manage and decommission 10 Magnox sites with 22 nuclear reactors. In addition, our International segment provides turn-key services for the disposal of radioactive sources from non-nuclear power generating facilities such as hospitals, research facilities and other manufacturing and industrial facilities.

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Results of Operations

The following table shows certain items from our income statements for the three months ended March 31, 2009 and 2008.

	Three Months Ended March 31,	
	2009	2008
	(in thousands of dollars)	
Revenues:		
Federal Services Segment	$ 66,081	$ 44,587
Commercial Services Segment	21,724	30,595
LP&D Segment	46,004	54,115
International Segment	303,300	372,456
Total revenues	437,109	501,753
Cost of revenues:		
Federal Services Segment	57,112	36,471
Commercial Services Segment	16,778	19,015
LP&D Segment	32,018	34,537
International Segment	280,603	338,197
Total cost of revenues	386,511	428,220
Gross profit:		
Federal Services Segment	8,969	8,116
Commercial Services Segment	4,946	11,580
LP&D Segment	13,986	19,578
International Segment	22,697	34,259
Total gross profit	50,598	73,533
Segment selling, general and administrative expenses:		
Federal Services Segment	3,353	1,768
Commercial Services Segment	1,768	1,936
LP&D Segment	2,223	2,684
International Segment	4,189	4,154
Total segment selling, general and administrative expenses	11,533	10,542
Segment operating income:		
Federal Services Segment	5,616	6,348
Commercial Services Segment	3,178	9,644
LP&D Segment	11,763	16,894
International Segment	18,508	30,105
Total segment operating income	39,065	62,991
Corporate selling, general and administrative expenses	19,246	17,720
Total income from operations	19,819	45,271
Interest expense	(7,956)	(12,538)
Other income (expenses), net	733	(2,061)
Income before income taxes and noncontrolling interests	12,596	30,672
Income tax expense	(4,274)	(11,184)

Income before noncontrolling interests	8,322	19,488
Net income attributable to noncontrolling interests	(195)	(195)
Net income	$ 8,127	$ 19,293

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Three Months Ended March 31, 2009 Compared to Three Months Ended March 31, 2008

Federal Services Segment

Revenues and cost of revenues in our Federal Services segment increased $21.5 million and $20.6 million, respectively, for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Gross profit increased $0.9 million while gross margin decreased to 13.6% for the three months ended March 31, 2009 from 18.2% for the three months ended March 31, 2008 primarily due to increased activity on lower margin contracts and decreased activity on higher margin contracts.

On March 14, 2008 we obtained majority voting rights and began consolidating our Uranium Disposition Services, LLC ("UDS") joint venture. For the three months ended March 31, 2009, we reported a full quarter of activity for UDS resulting in increased revenues of $8.8 million and cost of revenues of $8.8 million. The low gross margin for UDS of 0.5% and 1.6% for the three months ended March 31, 2009 and 2008, respectively, resulted in no significant contribution to gross profit as a result of the consolidation.

In June 2007, we were awarded a contract by the DOE to clean up the Atlas mill tailings near Moab, Utah. During the three months ended March 31, 2008, work on the contract was in the early stages. During the three months ended March 31, 2009, we performed significant work on the rail benches and increased excavation activities in preparation of transporting the mill tailings to the disposal cell. As a result, cost of revenues on the Moab contract increased $8.4 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. The contract with the DOE allows for the reimbursement of costs plus a fee, resulting in increased revenues of $9.3 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Thus, gross profit on the Moab contract increased $0.9 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 due to the recognition of award fee.

Our business development efforts related to engineering and technology projects within Federal Services during 2008 have resulted in several project awards that have increased revenues by $8.9 million, cost of revenues by $6.9 million and gross profit by $2.0 million for the three months ended March 31, 2009 compared to March 31, 2008. In addition, our Parallax operations contributed additional revenues, cost of revenues and gross profit of $2.2 million, $1.7 million and $0.5 million, respectively, for the three months ended March 31, 2009 compared to March 31, 2008 as a result of new contract awards and increased volume on current contracts.

These increases were offset, in part, by a collective decrease of revenues, cost of revenues and gross profit of $7.9 million, $5.3 million and $2.6 million, respectively, for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 related to two contracts at the DOE Hanford site and our Savannah River site operations contract.

Segment selling, general and administrative expenses in our Federal Services segment increased $1.6 million to $3.4 million for the three months ended March 31, 2009 from $1.8 million for the three months ended March 31, 2008. The increase is primarily attributable to increased consulting and business development costs due to work on several contract proposals during the first quarter of 2009.

Commercial Services Segment

Revenues and cost of revenues in our Commercial Services segment decreased $8.9 million and $2.2 million, respectively, for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Gross profit decreased $6.6 million while gross margin decreased to 22.8% for the three months ended March 31, 2009 from 37.8% for the three months ended March 31, 2008 due primarily to the relative profitability of the major projects being performed in each period.

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Revenues and gross profit in our large components operations decreased $3.5 million and $2.7 million, respectively, for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. This decrease was primarily due to the substantial completion of two significant large components projects during the first quarter of 2008.

Revenues and gross profit in our spent fuel operations decreased $3.4 million and $1.2 million, respectively, for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. This decrease was mostly attributable to the acceleration of work during the three months ended March 31, 2008 related to the closure of the Barnwell disposal site to states outside the Atlantic compact in July 2008.

In addition, one of our large commercial engineering and technology waste container design and fabrication projects was completed in December 2008. This resulted in a decrease of revenues and gross profit of $4.3 million and $2.4 million, respectively, for the three months ended March 31, 2009 compared to the three months ended March 31, 2008.

These decreases were offset, in part, by increased revenues of $1.0 million in our commercial decommissioning services for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 due to increased activity on one of our major projects. Cost of revenues related to our commercial decommissioning services increased $1.7 million resulting in a decrease in gross profit of $0.7 million for the three months ended March 31, 2009 compared to March 31, 2008. This is due to lower margins on one of our major fixed price contracts for the three months ended March 31, 2009 as a result of increased complexity of the project increasing the cost of revenues.

In addition, revenues in our liquid waste processing division increased $1.8 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 due to increased demand for liners. As a result, cost of revenues and gross profit increased $1.0 million and $0.8 million, respectively, for the three months ended March 31, 2009 compared to March 31, 2008.

Segment selling, general and administrative expenses in our Commercial Services segment decreased $0.1 million to $1.8 million for the three months ended March 31, 2009 from $1.9 million for the three months ended March 31, 2008. The decrease is primarily attributable to lower business development and license stewardship costs. All other segment selling, general and administrative expenses have remained stable.

LP&D Segment

Revenues and cost of revenues in our LP&D segment decreased $8.1 million and $2.5 million, respectively, for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Gross profit decreased $5.6 million while gross margin decreased to 30.4% for the three months ended March 31, 2009 from 36.2% for the three months ended March 31, 2008 due to decreased revenues.

Revenues at our Clive, Utah facility decreased $10.1 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 as a result of decreased volumes of waste processed and disposed mostly due to the completion of two major large components projects during the first quarter of 2008. This decrease in revenues resulted in a decrease of cost of revenues of $1.6 million related to lower taxes, fees and equipment costs mostly attributable to the lower volumes of waste processed and disposed. The majority of costs at our Clive, Utah facility are fixed, resulting in a disproportionate decrease in cost of revenues when compared to revenues. As a result, gross profit decreased $8.4 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008.

Revenues related to our transportation services decreased $1.1 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 due to lower shipments on major contracts. Cost of revenues related to our transportation services decreased $1.4 million due to lower

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shipments and additional reductions in operating and overhead costs, resulting in a $0.3 million increase in gross profit for the three months ended March 31, 2009.

These decreases were offset, in part, by increased revenues of $3.8 million for the three months ended March 31, 2009 compared to March 31, 2008 at our Bear Creek, Tennessee facility as a result of increased receipts of waste and processing of backlog carried over from 2008 during the three months ended March 31, 2009. The majority of costs at our Bear Creek, Tennessee facility are fixed, resulting in a comparable increase in gross profit of $3.4 million when compared to revenues.

Segment selling, general and administrative expenses in our LP&D segment decreased $0.5 million to $2.2 million for the three months ended March 31, 2009 from $2.7 million for the three months ended March 31, 2008. The decrease is mostly attributable to reduced labor costs, insurance expense, taxes and costs related to business development activities.

International Segment

Revenues in our International segment decreased $69.2 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Our revenues, prior to considering the effects of fluctuations in pound sterling exchange rates, increased $32.5 million. However, this increase was offset by a $101.7 million decrease due to a decline in pound sterling exchange rates during the three months ended March 31, 2009 compared to the same period in 2008. Of the $32.5 million increase in revenues, our revenues from the Magnox contracts increased $35.1 million mostly due to increased reimbursable contract cost base. This increase was offset, in part, by decreased revenues of $2.6 million related to our other UK operations.

Cost of revenues in our International segment decreased $57.6 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Our cost of revenues, prior to considering the effects of fluctuations in pound sterling exchange rates, increased $34.7 million. However, this increase was offset by a $92.3 million decrease due to a decline in pound sterling exchange rates during the three months ended March 31, 2009 compared to the same period in 2008. Of the $34.7 million increase in cost of revenues, our cost of revenues from the Magnox contracts increased $37.1 million primarily due to increased labor and subcontractor costs, including $31.6 million of employee termination benefits related to voluntary termination of approximately 200 employees at four of our Magnox sites. Benefits to be paid for the voluntary termination of these employees in accordance with the Magnox Lifetime Plan, an agreement with Magnox, the employees, and the trade unions, were pre-approved by the NDA Expenditure Review Panel during the three months ended March 31, 2009. All employee termination benefits are treated as part of the normal Magnox cost base and will be reimbursed by the NDA. This increase was offset, in part, by a decrease in cost of revenues of $2.4 million related to our other UK operations.

Gross profit in our International segment decreased $11.6 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Our gross profit, prior to considering the effects of fluctuations in pound sterling exchange rates, decreased $2.2 million. In addition, gross profit decreased $9.3 million due to a decline in pound sterling exchange rates during the three months ended March 31, 2009 compared to the same period in 2008. Gross profit margin in our International segment was 7.5% for the three months ended March 31, 2009 compared to 9.2% for the three months ended March 31, 2008. The decrease in gross profit margin is due to lower efficiency fees recognized from our Magnox contracts with the NDA for the three months ended March 31, 2009. Most of the efficiency fees related to the contract fiscal year ended March 31, 2008 were recognized during the three months ended March 31, 2008. For the contract fiscal year ended March 31, 2009, more of the efficiency fees were recognized in the quarter ended December 31, 2008 than in the same quarter of the prior year due to earlier achievement of milestones; thus reducing the amount recognized during the three months ended March 31, 2009. We expect this trend to continue in future periods.

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Segment selling, general and administrative expenses in our International segment remained constant at $4.2 million for the three months ended March 31, 2009 and 2008 and consist of bid and proposal expenses relating to potential contracts in the United Kingdom and other administrative expenses.

Corporate selling, general and administrative expenses

Corporate selling, general and administrative expenses increased $1.5 million, or 8.5%, to $19.2 million for the three months ended March 31, 2009 from $17.7 million for the three months ended March 31, 2008. This increase is primarily attributable to increased marketing and advertising expenses related to a television advertising campaign run during the first quarter of 2009 in Utah, increased legal fees primarily related to our declaratory judgment action with the Northwest Compact and increased professional fees incurred to recruit additional independent directors. Other corporate general and administrative costs have remained stable.

Interest expense

Interest expense decreased $4.5 million, or 36.0%, to $8.0 million for the three months ended March 31, 2009 from $12.5 million for the three months ended March 31, 2008. The decrease is primarily attributable to a decline in both our average borrowings outstanding and interest rates related to our credit facilities.

Other income (expense), net

Other income, net, increased $2.8 million, or 133.3%, to a net other income of $733,000 for the three months ended March 31, 2009 from a net other expense of $2.1 million for the three months ended March 31. 2008. The increase is mostly attributable to decreased losses of $2.2 million on our interest rate derivative contracts, increased gains on our foreign currency derivative contracts of $680,000 and increases in our proportional share of income from our joint ventures in which we have a non-controlling interest of $256,000. These increases are offset, in part, by increased net remeasurement losses of $183,000 on our US dollar denominated notes receivable with our UK subsidiary and other foreign currency transactions.

Income taxes

We recognized income tax expense of $4.3 million and $11.2 million for the three months ended March 31, 2009 and 2008, respectively, based on an estimated annual effective tax rate on our consolidated operations of 34.5% and 36.6%, respectively. The decrease in the estimated annual effective tax rate is mostly due to the effect of research and development credits in the UK.

Liquidity and Capital Resources

We finance our operations primarily through cash provided by operations. As of March 31, 2009, our principal sources of liquidity consisted of $30.9 million of cash and cash equivalents and $60.1 million of availability under the $75.0 million revolving portion of our credit facilities, which is net of $14.9 million of outstanding letters of credit. We also have a synthetic letter of credit facility of $100.0 million, of which $100.0 million of letters of credit were issued as of March 31, 2009.

During the three months ended March 31, 2009, our cash and cash equivalents decreased $17.5 million, to $30.9 million. This compares to an increase in cash and cash equivalents of $1.7 million for the three months ended March 31, 2008. During the three months ended March 31, 2009, we had net cash inflows from operating activities of $1.6 million. Cash from operating activities for the three months ended March 31, 2009 included net income of $8.1 million and significant non-cash expenses including depreciation and amortization expense of $11.7 million and equity-based compensation expense of $2.7 million. Cash from operating activities was also provided from increased

accounts payable and accrued liabilities of $84.6 million. The increase in accounts payable and accrued liabilities was primarily due to timing of payments to vendors of our Magnox contracts in the UK. Cash from operating activities was used by an increase in accounts receivable of $111.9 million primarily due to timing of collections on work performed on our contracts with the NDA.

During the three months ended March 31, 2009, we had net cash outflows from investing activities of $4.6 million, primarily related to purchases of property, plant and equipment. Our cash outflows from our financing activities were $12.8 million, primarily related to repayment of debt and payment of stockholder dividends.

Our principal need for liquidity has been, and will continue to be, for working capital, to pay down debt and for capital expenditures. We also expect to use cash flow from operations to pay quarterly dividends. However, the declaration and payment of future dividends to holders of our common stock will be at the discretion of our board of directors and will depend on many factors, including our results of operations, financial condition, liquidity requirements, restrictions that may be imposed by applicable law and our contracts and other factors deemed relevant by our board of directors. To the extent we maintain an annual dividend of $0.10 per share, our annual cash requirements for this dividend would be $8.8 million, based on the number of shares currently outstanding. We believe that our cash flow from operations, available cash and cash equivalents and available borrowings under the revolving portion of our credit facilities will be sufficient to meet our future liquidity needs, including the payment of such dividend, through at least the next twelve months.

We have accumulated benefit obligations related to our pension plans of $2.4 billion. See Note 19 to our audited consolidated financial statements included in Form 10-K filed February 27, 2009 for a more detailed discussion. Approximately 99% of the accumulated benefit obligation relates to the Magnox North and Magnox South pension plans (the "Magnox Plans"). The Magnox Plans are funded by contributions from employees and the NDA pursuant to a contractual arrangement. As a result, we are reimbursed for contributions made to the Magnox Plans under the terms of these contracts. Thus, we have no potential net funding requirements relative to the accumulated benefit obligation. The plan we are required to fund related to our employees of Reactor Sites Management Company Limited, a wholly-owned subsidiary in the UK, is currently funded by regular monthly payroll contributions from us and the employees. This will be the sole source of funding until at least mid-2010 at which time the next triennial valuation of the plan will be completed. Therefore, we do not expect there to be any implications to our liquidity within the next 12 months resulting from potential incremental cash payments to maintain funding requirements.

Although we have no specific current plans to do so, if we decide to pursue one or more significant strategic acquisitions, we may incur additional debt or sell additional equity to finance the purchase of those businesses.

Capital Expenditures

We had capital expenditures of $4.2 million and $1.3 million in three months ended March 31, 2009 and 2008, respectively. This increase of $2.9 million is mostly attributable to equipment required for the Atlas mill tailings contract. We expect capital expenditures for the year ending December 31, 2009 will be approximately $26.0 million, relating primarily to the implementation of an enterprise resource planning system (Oracle EBS R12) and equipment to be used at our decommissioning sites and at our facilities, which is in compliance with the debt covenants of our credit agreement. We anticipate the sources of funds for our anticipated capital expenditures will come from cash flows provided by our operating activities.

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Credit Facilities

We have entered into credit facilities with Citicorp North America, Inc., or CNAI, as administrative agent and collateral agent. Our credit facilities consist of a $75.0 million revolving credit facility, which matures on June 7, 2011, and a total of $770.0 million in term loan facilities, which mature on June 7, 2013, and a $100.0 million synthetic letter of credit facility, which expires on June 7, 2013.

The obligations under the credit facilities are unconditional and irrevocably guaranteed by each of our existing and subsequently acquired or organized domestic subsidiaries. In addition, the credit facilities and such guarantees are secured on a first- and second-priority basis by security interests (subject to permitted liens as defined in the credit agreements governing the credit facilities) in substantially all tangible and intangible assets owned by us and each of our domestic subsidiaries, subject to certain exceptions, including limiting pledges of voting stock of foreign subsidiaries to 65% of voting stock of first-tier foreign subsidiaries.

Borrowings under the credit facilities bear interest at a rate equal to (1) in the case of the first lien term loans, (i) the greater of the rate of interest announced by CNAI, from time to time, as its prime rate in effect at its principal office in the city of New York, and the federal funds rate plus 0.50% per annum (the "base rate"), plus 0.75% (or 0.50% when the leverage ratio (as defined in the credit agreements) as of the most recently completed fiscal quarter is less than 2.0 to 1.0) or (ii) for any portion of the term loans as to which we have elected to pay interest on a Eurodollar basis, LIBOR plus 2.25% (or 2.00% when the leverage ratio (as defined in the credit agreements) as of the most recently completed fiscal quarter is less than 2.0 to 1.0), (2) in the case of the revolving loans, (i) the base rate plus 0.75% or (ii) for any portion of the revolving loans as to which we have elected to pay interest on a Eurodollar basis, LIBOR plus 2.25% (3) in the case of synthetic letters of credit under the first lien credit facilities, 2.25% (or 2.00% when the leverage ratio (as defined in the related credit agreement) as of the most recently completed fiscal quarter is less than 2.0 to 1.0).

According to the terms of the credit agreements, at the end of each calendar quarter, we are required to make scheduled repayments of the term loans of $1.5 million, adjusted for optional prepayments made, provided that the final installment shall be equal to the amount outstanding of the term loan facilities.

We are generally also required to prepay borrowings under the credit facilities with (1) 100% of the net proceeds we receive from non-ordinary course asset sales or as a result of a casualty or condemnation, subject to reinvestment provisions, (2) 100% of the net proceeds we receive from the issuance of debt obligations other than specified debt obligations and (3) the excess, if any, of 50% (or, if our leverage ratio is less than 3.0 and greater than 1.0, 25%) of excess cash flow (as defined in the credit agreements) reduced by the aggregate amount of term loans optionally prepaid during the applicable fiscal year. Under the credit facilities, we are not required to prepay borrowings with excess cash flow if our leverage ratio is less than or equal to 1.0. As of March 31, 2009, we were required to make a mandatory prepayment of approximately $1.7 million based on our excess cash flow.

As of March 31, 2009, the weighted average interest rate under our credit facilities was 4.15%. At this rate and assuming an outstanding balance of $556.8 million as of March 31, 2009, our annual debt service obligations would be $29.0 million, consisting of $23.1 million of interest and $5.9 million of scheduled principal payments. However, due to optional prepayments made through March 31, 2009, only $1.5 million of our scheduled principal payments are currently due within the next year.

The credit facilities require us to maintain certain financial ratios, including maximum leverage ratios (based upon the ratios of total consolidated indebtedness and first lien indebtedness to consolidated operating cash flow) and a minimum cash interest coverage ratio (based upon the ratio of consolidated operating cash flow to consolidated cash interest expense), which are tested quarterly. Based on the formulas set forth in the credit agreements as March 31, 2009, we are required to

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maintain a maximum leverage ratio and a maximum first lien leverage ratio of 4.25 and 3.75, respectively, and minimum cash interest coverage ratio of 2.50. Failure to comply with these financial ratio covenants would result in a default under our credit facilities and, absent a waiver or an amendment from the lenders, preclude us from making further borrowings under our credit facilities and permit the lenders to accelerate all outstanding borrowings under the credit facilities. As of March 31, 2009, our total leverage, first lien leverage and interest coverage ratios were 3.36, 3.36 and 5.18, respectively. As such, we have determined that we are in compliance with these financial covenants.

The credit facilities also contain a number of affirmative and restrictive covenants including limitations on mergers, consolidations and dissolutions; sales of assets; investments and acquisitions; indebtedness; liens; affiliate transactions; and dividends and restricted payments. Under the credit facilities, we are permitted maximum annual capital expenditures of up to $30.0 million under the first lien credit facilities plus the lesser of (1) a one year carry-forward of the unused amount from the previous fiscal year and (2) 50% of the amount permitted for capital expenditures in the prior fiscal year. Our permitted maximum annual capital expenditures for 2009 is $45.0 million. The credit facilities contain events of default for non-payment of principal and interest when due, a cross-default provision with respect to other indebtedness having an aggregate principal amount of at least $5.0 million and an event of default that would be triggered by a change of control, as defined in the credit facilities. As of March 31, 2009, we were in compliance with all of our covenants and other obligations under the credit facilities.

Amendment Agreements

On December 11, 2007, we, through our subsidiary ZionSolutions, entered into an agreement with Exelon (the "Zion Agreement") to dismantle Exelon's Zion nuclear facility located in Zion, Illinois ("Zion Station"), which ceased operation in 1998.

Pursuant to the Zion Agreement, Exelon has agreed to transfer to ZionSolutions substantially all of the assets (other than land) associated with Zion Station, including assets held in nuclear decommissioning trusts. In consideration for Exelon's transfer of those assets, ZionSolutions has agreed to assume decommissioning and other liabilities associated with the Zion Station. ZionSolutions also agreed to take possession and control of the land associated with the Zion Station pursuant to a lease agreement to be executed at the closing. ZionSolutions will be obligated to complete the required decommissioning work according to an established schedule and to construct a dry cask storage facility on the land for spent nuclear fuel currently held in spent fuel pools at the Zion Station.

The parties agreed to enter into various other agreements to ensure the performance of the obligations of ZionSolutions under its contracts to complete the required decommissioning and other work. In particular, we have agreed to execute a Credit Support Agreement pursuant to which we will deliver a letter of credit in the face amount of $200.0 million, which will be held by Exelon. The occurrence of specified events of default would allow Exelon to draw upon the letter of credit.

In anticipation of the closing of this transaction, on July 16, 2008, we and our subsidiary, Duratek, entered into Amendment Agreements with our lenders under the current credit facilities. The Amendment Agreements provide that the existing credit agreements shall be amended and restated in their entirety upon satisfaction of certain conditions including the closing of the transaction with Exelon.

The amended and restated credit facilities were sought (a) to allow us to provide for a new letter of credit facility in the aggregate principal amount of $200.0 million (the "Zion letter of credit facility") pursuant to the Zion Agreement and (b) to return the existing synthetic letters of credit facility deposits and make term letter of credit facility loans in the aggregate principal amount of $100.0 million for which we have agreed to maintain restricted cash equal to the amount of the facility.

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The new term letter of credit facility and the restricted cash amount will be reflected on our consolidated balance sheet.

The Amendment Agreements provide that the amended and restated credit facilities will include letter of credit fees of 2.50% with respect to letters of credit issued under each of the revolving loan facility and the Zion letter of credit facility. In addition, the Amendment Agreements provide that the amended and restated credit facilities will provide for interest rates on loans as follows: (i) with respect to any term loan, (x) LIBOR plus 2.50% (or LIBOR plus 2.00% when the leverage ratio is less than 2.0 to 1.0) or (y) the base rate plus 1.25% (or the base rate plus 1.00% when the leverage ratio is less than 2.0 to 1.0), (ii) with respect to any revolving loan, (x) LIBOR plus 2.50% or (y) the base rate plus 1.25%, and (iii) with respect to any term letter of credit facility loan, LIBOR plus 2.50% (or LIBOR plus 2.00% when the leverage ratio is less than 2.0 to 1.0).

The Amendment Agreements provide that the amended and restated credit facilities are subject to the satisfaction of certain conditions precedent to closing, including those related to approval for the transactions contemplated by the Zion Agreement. In July 2008, we paid fees of approximately $6.4 million to the lenders to obtain the Amendment Agreements, which are being amortized over the remaining term of the credit facilities. In addition, once we have closed the Zion agreement and the Zion letter of credit is issued, we anticipate paying the providers of the Zion letter of credit facility approximately $7.5 million, which will be amortized over one year, which is the term of the Zion letter of credit facility.

Off Balance Sheet Arrangements

We have routine operating leases, primarily related to real estate and rail equipment, and investments in joint ventures at March 31, 2009.

As of March 31, 2009, we had outstanding floating-rate term loans of $556.8 million. Under our credit facilities, we are required to maintain one or more interest rate swap agreements for the aggregate notional amount of at least 33% of the outstanding aggregate principal amount of the term loans. Accordingly, we entered into a swap agreement effective December 18, 2008. As of March 31, 2009, the swap agreement had a notional amount of $200.0 million and a fair value liability of approximately $902,000.

We are required to post, from time to time, standby letters of credit and surety bonds to support contractual obligations to customers, self-insurance programs, closure and post-closure financial assurance and other obligations. As of March 31, 2009, we had $100.0 million in letters of credit issued under our synthetic letters of credit facilities and $14.9 million in letters of credit issued under our revolving credit facilities. As of March 31, 2009, we had $451,000 in surety bonds outstanding. With respect to the surety bonds, we have entered into certain indemnification agreements with the providers of the surety bonds, which would require funding by us only if we fail to perform under the contracts being insured and the surety bond issuer was obligated to make payment to the insured parties.

Our processing and disposal facilities operate under licenses and permits that require financial assurance for closure and post-closure costs. We provide for these requirements through a combination of restricted cash, cash deposits, letters of credit and insurance policies. As of March 31, 2009, the closure and post-closure state regulatory requirements for our facilities were $147.9 million, which amount is not determined on the same basis as the asset retirement obligation, or ARO, calculated under SFAS No. 143, *Accounting for Asset Retirement Obligations*.

Critical Accounting Policies

This management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements

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requires us to make estimates and assumptions about matters that are uncertain. These estimates and assumptions are often based on judgments that we believe to be reasonable under the circumstances, but all such estimates and assumptions are inherently uncertain and unpredictable. Actual results may differ from those estimates and assumptions, and it is possible that other professionals, applying their own judgment to the same facts and circumstances, could develop and support alternative estimates and assumptions that would result in material changes to our operating results and financial condition. For a further discussion of our critical accounting policies, see our Annual Report on Form 10-K for the year ended December 31, 2008, which was filed on February 27, 2009.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our primary market risk relates to changing interest rates. As of March 31, 2009, we had outstanding floating-rate term loan debt of $556.8 million, of which $3.2 million is currently due within the next year. Under our credit facilities, we are required to maintain one or more interest rate swap agreements for the aggregate notional amount of at least 33% of the outstanding aggregate principal amount of the term loans. As of March 31, 2009, our swap agreement had a notional amount of $200.0 million and a fair value liability of approximately $902,000.

A hypothetical interest rate change of 1% on our credit facilities would have changed interest expense for the three months ended March 31, 2009 by approximately $5.6 million. In addition, a hypothetical interest rate change of 1% on our swap agreement would have changed the fair value of the interest swap at March 31, 2009 by approximately $3.6 million. Changes in market interest rates would impact the fair value of our long-term obligations. As of March 31, 2009 we had outstanding borrowings under our credit facilities of $556.8 million with an approximate fair value of $490.0 million.

We have foreign currency exposure related to our operations in the United Kingdom as well as other foreign locations. This foreign currency exposure arises primarily from the translation or re-measurement of our foreign subsidiaries' financial statements into U.S. dollars. For example, a substantial portion of our annual sales and operating costs are denominated in pound sterling and we have exposure related to sales and operating costs increasing or decreasing based on changes in currency exchange rates. If the U.S. dollar increases in value against these foreign currencies, the value in U.S. dollars of the assets and liabilities originally recorded in these foreign currencies will decrease. Conversely, if the U.S. dollar decreases in value against these foreign currencies, the value in U.S. dollars of the assets and liabilities originally recorded in these foreign currencies will increase. Thus, increases and decreases in the value of the U.S. dollar relative to these foreign currencies have a direct impact on the value in U.S. dollars of our foreign currency denominated assets and liabilities, even if the value of these items has not changed in their original currency. We attempt to mitigate the impact of this exchange rate risk by utilizing financial instruments, including derivative transactions pursuant to our policies. As such, a 10% change in the U.S. dollar exchange rates in effect as of March 31, 2009, would cause a change in consolidated net assets of approximately $8.9 million and a change in gross profit of approximately $2.3 million, primarily due to pound sterling-denominated exposures.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Based on their evaluation as the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Exchange Act) are effective, based upon an evaluation of those controls and procedures required by paragraph (b) of Rule 13a-15 or Rule 15d-15 of the Exchange Act.

Changes in Internal Control Over Financial Reporting

There were no changes to our internal control over financial reporting that occurred as of the end of the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

Item 1. Legal Proceedings.

As previously reported, we have engaged in discussions with Sogin, SpA, the Italian state-owned utility company, to provide D&D and radioactive materials management services in support of the clean-up of Sogin's nuclear facilities. Our pending license application with the Nuclear Regulatory Commission ("NRC") to import material from Italy, to process it at our facility in Tennessee and to dispose of the residual material at our Clive facility in Utah has generated local and national expressions of opposition. We believe our license application is consistent with all applicable laws and regulations and with past practices. Moreover, the Italian material metals, paper and clothing is the same type of material that we handle routinely from the domestic nuclear industry.

The NRC has issued numerous licenses over the past ten years allowing the importation of low-level radioactive waste ("LLRW") to be processed and ultimately disposed at our Clive facility. Under these licenses, our Clive Facility has received Class A LLRW originating in Germany, Canada, France, Taiwan, and the United Kingdom.

The States of Tennessee and Utah have confirmed to the NRC that the proposed Italian project is consistent with the licenses and permits issued by those states. However, the Governor of the State of Utah announced on April 23, 2008 that he would send his representative to the May 8, 2008 meeting of the Northwest Interstate Compact on Low-Level Radioactive Waste Management (the "Northwest Compact") to vote against any proposal that would allow us to receive international waste at our Clive facility.

On May 5, 2008, we filed a declaratory judgment action in the U.S. District Court of Utah (the "Declaratory Judgment Action") asking the court to declare that (i) the Northwest Compact does not have regulatory authority over our Clive facility, which is a private commercial facility rather than a regional facility created by the Compact, (ii) the U.S. Constitution does not allow the Northwest Compact to discriminate between identical domestic and foreign materials handled at our Clive facility, and (iii) any effort by the Northwest Compact to restrict our receipt of foreign LLRW is pre-empted by federal statutes and regulations. The State of Utah and the Rocky Mountain Interstate Compact on Low-level Radioactive Waste have intervened as defendants in the declaratory judgment action.

At the Northwest Compact meeting on May 8, 2008, the representatives of the eight member States of the Northwest Compact, despite our commitment to restrict our receipt of international waste to 5% of the remaining capacity at our Clive facility, unanimously adopted a clarifying resolution proposed by the Utah committee member, clarifying that the Northwest Compact has never adopted a resolution permitting us to receive international waste at our Clive facility. We continue to believe that the Northwest Compact does not have regulatory authority over our Clive facility, and that neither the U.S. Constitution nor Federal law permits the Northwest Compact to prohibit us from receiving international waste at our Clive facility.

On October 6, 2008, the NRC approved an order holding in abeyance its decision with respect to our pending import license application until the U. S. District Court of Utah issues its ruling in the Company's declaratory judgment action.

On February 26, 2009, prior to the parties presenting oral arguments on their respective motions for summary judgment of the Declaratory Judgment Action, the U.S. District Court Judge stated that our Clive facility is not and never has been a "regional disposal facility." Following oral arguments, the court took under advisement the remaining issue of whether the Northwest Compact can nonetheless exercise jurisdiction over a private, non-compact facility.

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We intend to vigorously prosecute our declaratory judgment action, but we do not believe we will be able to process and dispose of any radioactive materials contemplated by the Italian initiative during fiscal 2009.

Item 1A. Risk Factors.

These risks and uncertainties have the potential to affect our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner.

We and our customers operate in a highly regulated industry that requires us and them to obtain, and to comply with, national, state and local government permits and approvals.

We and our customers operate in a highly regulated environment. Our facilities are required to obtain, and to comply with, national, state and local government permits and approvals. Any of these permits or approvals may be subject to denial, revocation or modification under various circumstances. Failure to obtain or comply with the conditions of permits or approvals may adversely affect our operations by temporarily suspending our activities or curtailing our work and may subject us to penalties and other sanctions. Although existing licenses are routinely renewed by various regulators, renewal could be denied or jeopardized by various factors, including:

- failure to provide adequate financial assurance for decommissioning or closure;
- failure to comply with environmental and safety laws and regulations or permit conditions;
- local community, political or other opposition;
- executive action; and
- legislative action.

In addition, if new environmental legislation or regulations are enacted or existing laws or regulations are amended or are interpreted or enforced differently, we or our customers may be required to obtain additional operating permits or approvals. Changes in requirements imposed by our environmental or other permits may lead us to incur additional expenses by requiring us to change or improve our waste management technologies and services to achieve and maintain compliance. We may be unable to meet all potential regulatory changes.

We and our customers operate in a politically sensitive environment, and the public perception of nuclear power and radioactive materials can affect our customers and us.

We and our customers operate in a politically sensitive environment. The risks associated with radioactive materials and the public perception of those risks can affect our business. Various public interest groups and political representatives frequently oppose the operation of processing and disposal sites for radioactive materials such as our Barnwell, South Carolina, Oak Ridge, Tennessee and Clive, Utah facilities. For example, public interest groups and the governor of Utah have made public statements regarding their desire to limit the source and volume of radioactive materials that we process and dispose at our Clive facility. Representatives in Congress have introduced federal legislation to ban the importation of foreign waste. If any efforts to limit our operations at these or any of our other current or future facilities were successful, then our business would suffer.

Opposition by third parties to particular projects can delay or prohibit the construction of new nuclear power plants and can limit the operation of nuclear reactors or the handling and disposal of radioactive materials. Adverse public reaction to developments in the use of nuclear power or the disposal of radioactive materials, including any high profile incident involving the discharge of radioactive materials, could directly affect our customers and indirectly affect our business. In the past, adverse public reaction, increased regulatory scrutiny and litigation have contributed to extended

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construction periods for new nuclear reactors, sometimes extending construction schedules by decades or more, contributing to the result that no new reactor has been ordered since the 1970s. Adverse public reaction also could lead to increased regulation or outright prohibition, limitations on the activities of our customers, more onerous operating requirements or other conditions that could have a material adverse impact on our customers and our business.

In addition, we may seek to address public and political opposition to our business activities through voluntary limitations on our operations. For example, as part of our response to public statements made by public interest groups and the governor of Utah regarding their desire to limit the source and volume of radioactive materials that we process and dispose at our Clive facility, we voluntarily agreed with the governor to withdraw a request for a license amendment to increase our capacity at our Clive facility. We are also experiencing both local and national expressions of opposition to the importation of LLRW from international sources, including opposition articulated in U.S. congressional proposals and from the Northwest Compact. The Northwest Compact, which consists of Alaska, Hawaii, Idaho, Montana, Oregon, Utah, Washington, and Wyoming, was created pursuant to a federal statute that enables states to enter into interstate compacts for the purposes of managing LLRW. In response to this opposition, we have volunteered to limit the amount of foreign LLRW accepted at our Clive facility to a maximum of 5% of the total remaining facility capacity. We also have filed a declaratory judgment action in the U.S. District Court in Utah seeking an order that the Northwest Compact does not have jurisdictional or regulatory authority over our Clive facility and that the Northwest Compact may not discriminate between domestic and foreign materials. Our actions to diffuse public and political opposition to our business can divert time and resources away from our core business operations and strategies, and failure to achieve the intended results of our actions may have a material adverse effect on our business, financial condition and results of operations.

Our business depends on the continued operation of our Clive, Utah facility.

Our disposal facility in Clive, Utah is a strategic asset and is vital to our business. This facility is the largest privately owned commercial facility for the disposal of LLRW in the United States, and contributed 4.8% and 6.2% of our revenues for the three months ended March 31, 2009 and 2008, respectively. Because of the greater profitability of the Clive facility in comparison with the rest of our business, a loss of revenue from Clive would have a disproportionate impact on our gross profit and gross margin. The Clive facility is subject to the normal hazards of operating any disposal facility, including accidents and natural disasters. In addition, access to the facility is limited, and any interruption in rail or other transportation services to and from the facility will affect our ability to operate the facility. Our Clive facility is highly regulated and subject to extensive licensing and permitting requirements and continuous air and ground water monitoring. Changes in federal, state or local regulations, including changes in the interpretation of those regulations, can affect our ability to operate the facility. Actions by states or the federal government may affect facility capacity, expansion or extension of the Clive facility. The Northwest Compact also has asserted it has authority over our Clive facility and is seeking to restrict our ability to import foreign LLRW for disposal at the facility, and federal legislation has been introduced to prohibit the importation of foreign LLRW waste. Such actions may hinder, delay or stop shipments to the facility, which could seriously impair our ability to execute disposal projects and significantly reduce future revenues. We believe that we have sufficient capacity for more than 30 years of operations based on our estimate of future disposal volumes, our ability to optimize disposal capacity utilization and our assumption that we will obtain a license amendment to convert a disposal cell originally intended for 11e(2) waste to Class A LLRW. If we are unable to obtain the license amendment, our projected capacity to dispose of Class A LLRW would be materially reduced. If future disposal volumes increase beyond our expectations or if our other assumptions prove to be incorrect, then the remaining capacity at Clive would be exhausted more quickly than projected.

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Any interruption in our operation of the Clive facility or decrease in the effective capacity of the facility would adversely affect our business, and any prolonged disruption in the operation of the facility or reduction in the capacity or useful life of the facility would have a material adverse effect on our business, financial condition and results of operations.

Our quarterly operating results may fluctuate significantly and may not meet our financial guidance or published analyst forecasts, which could have a negative effect on the price of our common stock.

Our quarterly operating results may fluctuate significantly because of a number of factors, many of which are outside our control, including:

- the seasonality of our contracts, the spending cycle of our government customers and the spending patterns of our commercial customers;
- the number and significance of projects commenced and completed during a quarter;
- uncertainty in timing for receiving government contract awards;
- our contract with the NDA, under which we generally recognize most efficiency fees in the first calendar quarter of each year;
- unanticipated changes in contract performance, particularly with contracts that have funding limits;
- the timing of resolutions of change orders, requests for equitable adjustments and other contract adjustments;
- decisions by customers to terminate our contracts;
- delays incurred in connection with a project;
- seasonal variations in shipments of radioactive materials;
- weather conditions that delay work at project sites;
- the timing of expenses incurred in connection with acquisitions or other corporate initiatives;
- staff levels and utilization rates;
- changes in the prices of services offered by our competitors; and
- general economic or political conditions.

Fluctuations in quarterly results, lower than anticipated revenues or our failure to meet financial guidance or published analysts' forecasts could have a negative effect on the price of our common stock.

Our international operations involve risks that could have a material adverse effect on our results of operations.

For the three months ended March 31, 2009, we derived 69.4% and 47.4% of our revenues and segment operating income, respectively, and for the three months ended March 31, 2008, we derived 74.2% and 47.8% of our revenues and segment operating income, respectively, from our operations outside of North America. Our business is dependent on the success of our international operations, and we expect that our international operations will continue to account for a significant portion of our total revenues. In addition to risks applicable to our business generally, our international operations are subject to a variety of heightened or distinct risks, including:

- recessions in foreign economies and the impact on our costs of doing business in those countries;
- difficulties in staffing and managing foreign operations;

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- changes in regulatory requirements;
- foreign currency fluctuations;
- the adoption of new, and the expansion of existing, trade restrictions;
- acts of war and terrorism;
- the ability to finance efficiently our foreign operations;
- social, political and economic instability;
- increases in taxes;
- limitations on the ability to repatriate foreign earnings; and
- natural disasters or other crises.

Changes in existing environmental and other laws, regulations and programs could harm our business.

A significant amount of our business of processing and disposing of radioactive materials derives directly or indirectly from existing national and state laws, regulations and programs related to pollution and environmental protection. National, state and local environmental legislation and regulations require substantial expenditures and impose liabilities for noncompliance. Accordingly, a real or perceived relaxation or repeal of these laws and regulations, or changes in government policies regarding the funding, implementation or enforcement of these programs, could result in a material decline in demand for nuclear services. The ultimate impact of the proposed changes will depend upon a number of factors, including the overall strength of the economy and the industry's views on the cost-effectiveness of remedies available under the changed laws and regulations.

Our operations are subject to taxation by the U.S. and UK governments, the State of Utah, Tooele County and other foreign governments. In the event of a material increase in our taxes resulting from an increase in our effective tax rate or change in our scheme of taxation, we may not have the ability to pass on the effect of such increase to our customers and, as a result, our stockholders could bear the burden of any such tax increase. The risk of a material tax increase may be exacerbated by political pressure to limit our operations. *See* " We and our customers operate in a politically sensitive environment, and the public perception of nuclear power and radioactive materials can affect our customers and us."

Our facilities are also subject to political actions by government entities which can reduce or completely curtail their operations. For example, the State of South Carolina closed the Barnwell disposal site on July 1, 2008 to customers outside of the Atlantic Compact States of South Carolina, New Jersey and Connecticut. Although the Barnwell closure did not have a significant impact on our revenues or net income, political pressures to reduce or curtail other operations could have a material adverse effect on our results of operations.

Our life-of-plant contracts may not remain effective through a nuclear power plant's decontamination and decommissioning.

Although our life-of-plant contracts are intended to provide us with revenue streams from the processing and disposal of substantially all LLRW and mixed low-level waste ("MLLW") generated over the remaining lives of nuclear power plants operated by our commercial power and utility customers, and ultimately waste disposal revenue streams when the plants are shut down, these

contracts may not actually remain effective for that entire period. A typical "life-of-plant" contract may terminate before D&D because the contract may:

- have a shorter initial term than the useful life of the plant and the contract may not be extended by the utility;
- include a provision that allows the customer to terminate the contract after a certain period of time or upon certain events;
- allow for renegotiation of pricing terms if market conditions change; and
- allow for renegotiation of pricing terms based on increases in taxes and pass-through or other costs.

The early termination or renegotiation of a life-of-plant contract may reduce our revenues and profits. In addition, life-of-plant contracts may expose us to liability in the event that government bodies limit our ability to accept radioactive materials by capping the capacity of one or more of our disposal facilities or taking other actions.

We may not be successful in winning new business mandates from our government and commercial customers.

We must be successful in winning new business mandates from our government and commercial customers to replace revenues from projects that are nearing completion and to increase our revenues. Our business and operating results can be harmed by the size and timing of a single material contract. For example, during 2005, we were the primary subcontractor to Kaiser-Hill Company, LLC for the transportation and disposal of LLRW, MLLW and other contaminated materials from the DOE's Rocky Flats Environmental Technology site near Denver, Colorado. Pursuant to this contract, we generated $105.4 million of revenues during 2005. The DOE declared the clean-up complete in October 2005, and we have not generated significant revenues from Rocky Flats since 2005.

Our business strategy includes bidding on government contracts as a lead prime contractor in a consortium. We expect to bid on a significant portion of the approximately $25.8 billion of federal nuclear services contracts that we estimate will be awarded within the next five years. In the past, we have operated primarily as a subcontractor or in a minority position on a prime contractor team. In pursuing a lead prime contractor role, we will be competing directly with a number of large national and regional nuclear services firms that may possess or develop technologies superior to our technologies and have greater financial, management and marketing resources than we do. Many of these companies also have long-established customer relationships and reputations. As a result, we may not be successful in being awarded the lead prime contractor role for any of these contracts.

We may fail to win re-bids in the United Kingdom for the Southern and Northern Region decommissioning contracts currently held by our subsidiary RSMC.

In December 2008, the NDA announced that the current NDA contracts held by RSMC through its subsidiaries, Magnox North Limited and Magnox South Limited, in relation to the Southern Region sites and Northern Region sites will be put out for re-bid in 2011. During the contract year ended March 31, 2009, RSMC recognized revenues of $1.1 billion from these contracts. We expect the competition for these contracts to be intense, and our failure to win the re-bid of either or both contracts would have a material adverse effect on our results of operations. Even if we win the re-bid, the participation of a partner could reduce our profits from these contracts. In addition, any limitations on our ability to import international waste to our Clive facility could reduce one of our competitive advantages in competing for these contracts. See risk factor "We and our customers operate in a politically sensitive environment, and the public perception of nuclear power and radioactive materials can affect our customers and us."

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The loss of one or a few customers could have an adverse effect on us.

One or a few government and commercial customers have in the past and may in the future account for a significant portion of our revenues in any one year or over a period of several consecutive years. For example, the NDA accounts for virtually all of our revenue in the International segment (which is our largest segment based on 2008 revenues). For the three months ended March 31, 2009 and 2008, respectively, 69.7% and 73.9% of our revenues were from contracts funded by the NDA. In addition, from time to time we typically have contracts with various offices within the DOE, including with the Office of Environmental Management, the Office of Civilian Radioactive Waste Management, the National Nuclear Security Administration and the Office of Nuclear Energy. For the three months ended March 31, 2009 and 2008, respectively, 12.4% and 8.8% of our revenues were from contracts funded by the DOE. Because customers generally contract with us for specific projects, we may lose these significant customers from year to year as their projects with us are completed. Our inability to replace this business with other projects could have an adverse effect on our business and results of operations.

The elimination or any modification of the Price-Anderson Act's indemnification authority could harm our business.

In the United States, the Atomic Energy Act of 1954, as amended (the "AEA"), comprehensively regulates the manufacture, use and storage of radioactive materials. Section 170 of the AEA, which is known as the Price-Anderson Act, supports the nuclear services industry by offering broad indemnification to commercial nuclear power plant operators and DOE contractors for liabilities arising out of nuclear incidents at power plants licensed by the NRC and at DOE nuclear facilities. That indemnification protects not only the NRC licensee or DOE prime contractor, but also companies like us that work under contract or subcontract for a licensed power plant or under a DOE prime contract or transporting radioactive material to or from a site. The indemnification authority of the NRC and DOE under the Price-Anderson Act was extended through 2025 by the Energy Policy Act of 2005.

The Price-Anderson Act's indemnification provisions generally do not apply to our processing and disposal facilities, and do not apply to all liabilities that we might incur while performing services as a contractor for the DOE and the nuclear energy industry. If an incident or evacuation is not covered under Price-Anderson Act indemnification, we could incur substantial losses, regardless of fault, which could have an adverse effect on our results of operations and financial condition. In connection with international transportation of toxic, hazardous and radioactive materials, it is possible for a claim to be asserted which may not fall within the indemnification provided by the Price-Anderson Act. If such indemnification authority is not applicable in the future, our business could be adversely affected if the owners and operators of new facilities fail to retain our services in the absence of commercially adequate insurance and indemnification.

Our existing and future customers may reduce or halt their spending on nuclear services from outside vendors, including us.

A variety of factors may cause our existing or future customers to reduce or halt their spending on nuclear services from outside vendors, including us. These factors include, but are not limited to:

- accidents, terrorism, natural disasters or other incidents occurring at nuclear facilities or involving shipments of nuclear materials;
- disruptions in the nuclear fuel cycle, such as insufficient uranium supply or conversion;
- the financial condition and strategy of the owners and operators of nuclear reactors;
- civic opposition to or changes in government policies regarding nuclear operations; or

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- a reduction in demand for nuclear generating capacity.

These events also could adversely affect us to the extent that they result in the reduction or elimination of contractual requirements, the suspension or reduction of nuclear reactor operations, the reduction of supplies of nuclear raw materials, lower demand for nuclear services, burdensome regulation, disruptions of shipments or production, increased operational costs or difficulties or increased liability for actual or threatened property damage or personal injury.

Economic downturns and reductions in government funding could harm our businesses.

Demand for our services has been, and we expect that demand will continue to be, subject to significant fluctuations due to a variety of factors beyond our control, including economic and industry conditions. The stress experienced by global capital markets that began in the second half of 2007 substantially increased during 2008 and has continued into 2009. Recently, concerns over inflation, energy costs, geopolitical issues, the availability and cost of credit, the U.S. mortgage market and a declining real estate market have contributed to increased volatility and diminished expectations for the global economy and expectations of slower global economic growth going forward. These factors, combined with volatile oil prices, declining business and consumer confidence and increased unemployment, have precipitated an economic recession.

During economic downturns, the ability of private and government entities to make expenditures on nuclear services may decline significantly. Economic or political conditions may be unfavorable to our industry and there may be significant fluctuations adversely affecting our industry as a whole. In addition, our operations depend, in part, upon government funding, particularly funding levels at the NDA or DOE. Significant changes in the level of government funding (for example, the annual budget of the NDA or DOE) or specifically mandated levels for different programs that are important to our business could have an unfavorable impact on our business, financial position, results of operations and cash flows. For example, although the Magnox contract funding for the 2008/09 contract year increased over the 2007/08 contract year, the NDA has stated that the Magnox North and Magnox South sites, for which we are currently a prime contractor, may receive reduced funding allocations in the future so that the NDA may address other sites that contain more hazardous materials that pose a greater degree of risk. In addition, it is likely that Congress will not pass a fiscal year 2009 appropriations bill until the new administration has been in office for some time, which may delay spending on new government contracts.

In addition, current market conditions have exerted downward pressure on the price of our common stock, which could limit our ability to raise capital, if necessary, through borrowings or the issuance of additional securities. A protracted economic downturn could exacerbate these adverse conditions. Although numerous governments have taken steps to mitigate the disruption to financial markets, there can be no assurances that government responses will restore consumer confidence for the foreseeable future.

The current state of the financial markets could also exert pressure on our customers and could limit their ability to secure working capital. This may impact their liquidity and their ability to make timely payments of their invoices to us. The inability of our customers to make timely payments of our invoices may negatively impact our cash flows.

As a government contractor, we are subject to extensive government regulation, and our failure to comply with applicable regulations could subject us to penalties that may restrict our ability to conduct our business.

Our government contracts, which are primarily with the NDA and the DOE, are a significant part of our business. Allowable costs under U.S. government contracts are subject to audit by the U.S. government. Similarly, some UK contracts are subject to audit by UK regulatory authorities, including the NDA. If these audits result in determinations that costs claimed as reimbursable are not allowed

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costs or were not allocated in accordance with applicable regulations, we could be required to reimburse government authorities for amounts previously received.

Government contracts are often subject to specific procurement regulations, contract provisions and a variety of other requirements relating to the formation, administration, performance and accounting of these contracts. Many of these contracts include express or implied certifications of compliance with applicable regulations and contractual provisions. We may be subject to qui tam litigation brought by private individuals on behalf of the government under the Federal Civil False Claims Act, which could include claims for up to treble damages. Additionally, we may be subject to the Truth in Negotiations Act, which requires certification and disclosure of all factual costs and pricing data in connection with contract negotiations. If we fail to comply with any regulations, requirements or statutes, our existing government contracts could be terminated or we could be suspended from government contracting or subcontracting. If one or more of our government contracts are terminated for any reason, or if we are suspended or debarred from government work, we could suffer a significant reduction in expected revenues and profits. Furthermore, as a result of our government contracting, claims for civil or criminal fraud may be brought by the government for violations of these regulations, requirements or statutes.

Our commercial customers may decide to store radioactive materials on-site rather than contract with us to transport, process and dispose of the radioactive materials at one of our off-site facilities.

Our LP&D segment's results of operations may be affected by the decisions of our commercial customers to store radioactive materials on-site. There has been little regulatory, political or economic pressure for commercial utilities and power companies to dispose of radioactive materials at off-site facilities. Some of these commercial entities have the ability to store radioactive materials generated by their operations on-site, instead of contracting with an outside service provider, such as us, to transport, process and dispose of the radioactive materials at an off-site location, such as our Clive facility. The decision to store radioactive materials on-site rather than contracting to dispose of them at an off-site facility may be influenced by the accounting treatment for radioactive materials. Currently, the liability for the disposal of radioactive materials stored on-site may be capitalized on the owner's balance sheet and amortized over the expected on-site storage period. In contrast, radioactive materials shipped off-site for disposal are expensed during the period in which the materials are shipped off-site. The NRC has rejected our proposal to undertake an amendment of current NRC rules to permit operators of nuclear reactors to access decommissioning funds for transportation and disposal of retired large components of currently operating nuclear power plants. We will continue to work with the NRC to request, on a case-by-case basis, that operators of these nuclear reactors be permitted to access decommissioning funds for transportation and disposal of retired large components. The NRC's refusal to grant such requests could have an adverse impact on the prospects for our Commercial Services and LP&D segments.

We may not be successful in entering into license stewardship arrangements with owners and operators of shut-down nuclear reactors.

We are marketing our license stewardship solution to the owners and operators of shut-down nuclear reactors in SAFSTOR or monitored storage. Although we believe that our license stewardship initiative is an attractive alternative to deferring decommissioning and related risks to the reactor owner, including future cost increases and the future availability of disposal capacity, the following factors may adversely affect our license stewardship initiative:

- owners and operators of shut-down nuclear reactors have the option of maintaining their reactors in SAFSTOR or monitored storage, allowing their decommissioning trust funds to grow and eventually pursue a D&D program in the future;

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- uncertainty regarding the appropriate tax and regulatory treatment of aspects of our license stewardship initiative may prevent owners and operators of nuclear power plants from entering into these kinds of arrangements with us;
- if a plant's decommissioning trust fund has decreased or failed to grow, the fund may not be large enough to make license stewardship economically feasible;
- we may fail to obtain the necessary approvals and licenses from the NRC and the applicable state public utility commission on terms we find acceptable;
- these contracts may require us to post letters of credit or surety bonds that we may be unable to obtain on reasonable terms, or at all;
- as the owner of the reactor assets and the holder of the NRC license, we may be subject to unforeseen environmental liabilities, including fines for non-compliance with environmental requirements and costs associated with the clean-up of unanticipated contamination; and
- if we underestimate the costs or timing of D&D activities at a particular site, the project may not be profitable for us.

As discussed elsewhere in this report, we have entered into an agreement with Exelon to dismantle Exelon's nuclear facility located in Zion, Illinois, which ceased operation in 1998. The NRC has issued an order approving the license transfer of the facility operating licenses and conforming license amendments from Exelon to ZionSolutions subject to the performance of certain conditions. However, because of the current market downturn, the nuclear decommissioning trust fund balance for the Zion Station, a significant portion of which is invested in the stock market, has declined in value. As a result, we intend to defer the completion of this transaction until we reaffirm that there is sufficient value in the decommissioning trust funds to ensure adequate funds for the accelerated decommissioning of the plant. As of March 31, 2009, we have incurred costs of $12.7 million that have been deferred until the closing of the transaction. We will continue to defer these costs until we close the transaction, at which time we will recognize the costs and related revenues. If we determine that it is not probable that we will close this transaction, we will expense these costs in the period of such determination.

Our inability to successfully complete the transaction with Exelon or to enter into other license stewardship arrangements may harm our business, financial position, results of operations and cash flows.

We are subject to liability under environmental laws and regulations.

We are subject to a variety of environmental, health and safety laws and regulations governing, among other things, discharges to air and water, the handling, storage and disposal of hazardous or radioactive materials and wastes, the remediation of contamination associated with releases of hazardous substances and human health and safety. These laws and regulations and the risk of attendant litigation can cause significant delays to a project and add significantly to its cost. Our projects often involve highly regulated materials, including hazardous and radioactive materials and wastes. Environmental laws and regulations generally impose limitations and standards for regulated materials and require us to obtain permits and licenses and comply with various other requirements. Fees associated with such environmental permits and licenses can be costly. In addition, the improper characterization, handling, testing, transportation or disposal of regulated materials or any other failure to comply with these environmental, health and safety laws, regulations, permits or licenses have resulted in fines or penalties from time to time and could subject us and our management to civil and criminal penalties, the imposition of investigatory or remedial obligations or the issuance of injunctions that could restrict or prevent our operations. These laws and regulations may also become more stringent, or be more stringently enforced, in the future.

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Various national, state and local environmental laws and regulations, as well as common law, may impose liability for property damage and costs of investigation and clean-up of hazardous or toxic substances on property currently or previously owned by us or arising out of our waste management, environmental remediation or nuclear D&D activities. These laws may impose responsibility and liability without regard to knowledge of or causation of the presence of contaminants. The liability under these laws can be joint and several, mp>

(38,464)

(246,452)

Other current assets

3,480

(7,336)

Auto loan receivables, net

(1,045,386)

(632,342)

Other assets

(6,714)

(506)

Net increase (decrease) in:

Accounts payable, accrued expenses and other current

liabilities and accrued income taxes

1,707

(102,666)

Other liabilities

(266)

(13,220)

NET CASH USED IN OPERATING ACTIVITIES

(493,140)

(499,228)

INVESTING ACTIVITIES:

Capital expenditures

(212,900)

(184,942)

Proceeds from sales of assets

5,143

Increase in restricted cash from collections on auto loan receivables

(22,508)

(46)

Increase in restricted cash in reserve accounts

(7,826)

(6,912)

Release of restricted cash from reserve accounts

15,022

15,980

Purchases of money market securities, net

(3,833)

(2,088)

Purchases of investments available-for-sale

(1,868)

(1,525)

Sales of investments available-for-sale

71

318

NET CASH USED IN INVESTING ACTIVITIES

(228,699)

(179,215)

FINANCING ACTIVITIES:

Increase (decrease) in short-term debt, net

932

(237)

Payments on finance and capital lease obligations

(14,963)

(10,365)

Issuances of non-recourse notes payable

5,300,000

4,010,000

Payments on non-recourse notes payable

(4,185,021)

(3,313,626)

Repurchase and retirement of common stock

(196,748)

(51,091)

Equity issuances, net

19,967

29,486

Excess tax benefits from share-based payment arrangements

13,066

16,728

NET CASH PROVIDED BY FINANCING ACTIVITIES

937,233

680,895

Increase in cash and cash equivalents

215,394

2,452

Cash and cash equivalents at beginning of year

449,364

442,658

CASH AND CASH EQUIVALENTS AT END OF PERIOD

$

664,758

$

445,110

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 superstores.

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

2.Accounting Policies

Basis of Presentation and Use of Estimates. The accompanying interim unaudited consolidated financial statements include the accounts of CarMax and our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. These consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, such interim consolidated financial statements reflect all normal recurring adjustments considered necessary to present fairly the financial position and the results of operations and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full fiscal year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended February 28, 2013.

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. Amounts and percentages may not

total due to rounding.

Cash and Cash Equivalents. Cash equivalents of $647.5 million as of November 30, 2013, and $430.3 million as of February 28, 2013, consisted of highly liquid investments with original maturities of three months or less.

Restricted Cash from Collections on Auto Loan Receivables. Cash accounts totaling $246.8 million as of November 30, 2013, and $224.3 million as of February 28, 2013, consisted of collections of principal and interest payments on securitized auto loan receivables that are restricted for payment to the securitization investors pursuant to the applicable securitization agreements.

Securitizations. We maintain a revolving securitization program composed of two warehouse facilities ("warehouse facilities") that we use to fund auto loan receivables originated by CAF until they are funded through a term securitization or alternative funding arrangement. We sell the auto loan receivables to a wholly owned, bankruptcy-remote, special purpose entity that transfers an undivided percentage ownership interest in the receivables, but not the receivables themselves, to entities formed by third-party investors. 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 the auto loan receivables initially securitized through the warehouse facilities. In these transactions, a pool of auto loan receivables is sold to a bankruptcy-remote, special purpose entity that, in turn, transfers the receivables to a special purpose securitization trust. The securitization trust issues asset-backed securities, secured or otherwise supported by the transferred receivables, and the proceeds from the sale of the asset-backed securities are used to finance the securitized receivables.

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

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

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

See Notes 4 and 9 for additional information on auto loan receivables and non-recourse notes payable.

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

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

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

Property and Equipment, Net. Property and equipment is reported net of accumulated depreciation of $707.7 million and $649.0 million as of November 30, 2013, and February 28, 2013, 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 totaled $34.1 million as of November 30, 2013, and $41.3 million as of February 28, 2013.

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 was $40.6 million as of November 30, 2013, and $35.0 million as of February 28, 2013.

Derivative Instruments and Hedging Activities. We enter into derivative instruments to manage exposures that arise from business activities that result in the future known receipt or payment of uncertain cash amounts, the values of which are impacted by interest rates. We recognize the derivatives at fair value as either current assets or current liabilities on the consolidated balance sheets, and where applicable, such contracts covered by master netting agreements are reported net. Gross positive fair values are netted with gross negative fair values by counterparty. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether we have elected to designate a derivative in

a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. We may enter into derivative contracts that are intended to economically hedge certain risks, even though hedge accounting may not apply or we do not elect to apply hedge accounting. See Note 5 for additional information on derivative instruments and hedging activities.

Recent Accounting Pronouncements. The Financial Accounting Standards Board did not issue any new accounting pronouncements relevant to us nor did any recent accounting pronouncements become effective for us in our fiscal 2014 third quarter.

3.CarMax Auto Finance Income

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

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. 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 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.

	Three Months Ended November 30				Nine Months Ended November 30			
(In millions)	2013	% (1)	2012	% (1)	2013	% (1)	2012	% (1)
Interest margin:								
Interest and fee income	$ 138.3	8.1	$ 125.1	9.1	$ 409.0	8.4	$ 368.9	9.3
Interest expense	(22.2)	(1.3)	(23.3)	(1.7)	(67.6)	(1.4)	(72.4)	(1.8)
Total interest margin	116.1	6.8	101.8	7.4	341.4	7.0	296.5	7.5
Provision for loan losses	(19.7)	(1.2)	(18.1)	(1.3)	(49.0)	(1.0)	(40.2)	(1.0)
Total interest margin after provision for loan losses	96.4	5.7	83.7	6.1	292.4	6.0	256.3	6.5

Other income			0.2		0.1			
Direct expenses:								
Payroll and fringe benefit expense	(5.6)	(0.3)	(5.2)	(0.4)	(16.7)	(0.3)	(15.9)	(0.4)
Other direct expenses	(6.9)	(0.4)	(6.2)	(0.5)	(20.5)	(0.4)	(17.1)	(0.4)
Total direct expenses	(12.5)	(0.7)	(11.4)	(0.8)	(37.2)	(0.8)	(33.0)	(0.8)
CarMax Auto Finance income	$ 83.9	4.9	$ 72.5	5.3	$ 255.3	5.2	$ 223.3	5.7
Total average managed receivables	$ 6,805.3		$ 5,477.4		$ 6,491.4		$ 5,266.0	

(1)Annualized percent of total average managed receivables.

4.Auto Loan Receivables

Auto loan receivables include amounts due from customers related to retail vehicle sales financed through CAF and are presented net of an allowance for estimated loan losses. We use warehouse facilities to fund auto loan receivables originated by CAF until they are funded 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 $6.97 billion as of

November 30, 2013, and $5.86 billion as of February 28, 2013. See Notes 2 and 9 for additional information on securitizations and non-recourse notes payable.

Auto Loan Receivables, Net

(In millions)	As of November 30 2013	As of February 28 2013
Warehouse facilities	$ 807.0	$ 792.0
Term securitizations	5,948.5	4,989.7
Other receivables (1)	163.5	151.6
Total ending managed receivables	6,919.0	5,933.3
Accrued interest and fees	29.1	24.9
Other	12.1	(5.0)
Less allowance for loan losses	(67.9)	(57.3)
Auto loan receivables, net	$ 6,892.3	$ 5,895.9

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

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

(In millions)	As of November 30 2013 (1)	% (2)	As of February 28 2013 (1)	% (2)
A	$ 3,373.8	48.8	$ 2,841.4	47.9

B	2,574.4	37.2	2,265.6	38.2
C and other	970.8	14.0	826.3	13.9
Total ending managed receivables	$ 6,919.0	100.0	$ 5,933.3	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)	2013	% (1)	2012	% (1)	2013	% (1)	2012	% (1)
Balance as of beginning of period	$ 65.9	1.0	$ 49.5	0.9	$ 57.3	1.0	$ 43.3	0.9
Charge-offs	(36.3)		(28.2)		(94.5)		(73.1)	
Recoveries	18.6		14.9		56.1		43.9	
Provision for loan losses	19.7		18.1		49.0		40.2	
Balance as of end of period	$ 67.9	1.0	$ 54.3	1.0	$ 67.9	1.0	$ 54.3	1.0

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

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

Past Due Receivables

	As of November 30		As of February 28	
(In millions)	2013	% (1)	2013	% (1)
Total ending managed receivables	$ 6,919.0	100.0	$ 5,933.3	100.0
Delinquent loans:				
31-60 days past due	$ 138.9	2.0	$ 109.5	1.8
61-90 days past due	46.0	0.7	32.7	0.6
Greater than 90 days past due	16.2	0.2	12.0	0.2
Total past due	$ 201.1	2.9	$ 154.2	2.6

(1)Percent of total ending managed receivables.

5.Derivative Instruments and Hedging Activities

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

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

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

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

For derivatives that are designated and qualify as cash flow hedges, the effective portion of changes in the fair value is initially recorded in accumulated other comprehensive loss ("AOCL") and is subsequently reclassified into CAF income in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in CAF income. Amounts reported in AOCL related to derivatives will be reclassified to CAF income as interest expense is incurred on our future issuances of fixed-rate debt. During the next 12 months, we estimate that an additional $10.0 million will be reclassified as a decrease to CAF income.

As of November 30, 2013, and February 28, 2013, we had interest rate swaps outstanding with combined notional amounts of $783.0 million and $750.0 million, respectively, which were designated as cash flow hedges of interest rate risk.

Non-designated Hedges. Derivative instruments not designated as accounting hedges are not speculative. These instruments are used to limit risk for investors in the warehouse facilities. Changes in the fair value of derivatives not designated as accounting hedges are recorded directly in CAF income.

As of November 30, 2013, we had no derivatives that were not designated as accounting hedges. As of February 28, 2013, we had interest rate caps outstanding with offsetting (asset and liability) notional amounts of $615.5 million that were not designated as accounting hedges.

Fair Values of Derivative Instruments

	As of November 30, 2013		As of February 28, 2013	
(In thousands)	Assets	Liabilities	Assets	Liabilities
Derivatives designated as accounting hedges:				
Interest rate swaps (1)		(2,889)		(517)
Total derivatives designated as accounting hedges		(2,889)		(517)
Derivatives not designated as accounting hedges:				
Interest rate caps (2)			26	(26)
Total derivatives not designated as accounting hedges			26	(26)
Total	$	$ (2,889)	$ 26	$ (543)

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

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

Effect of Derivative Instruments on Comprehensive Income

	Three Months Ended November 30		Nine Months Ended November 30	
(In thousands)	2013	2012	2013	2012
Derivatives designated as accounting hedges:				
Loss recognized in AOCL (1)	$ (7,421)	$ (894)	$ (4,069)	$ (7,286)
Loss reclassified from AOCL into CAF income (1)	$ (2,155)	$ (3,327)	$ (7,665)	$ (9,855)
Gain recognized in CAF Income (2)	$	$	$ 78	$

Derivatives not designated as accounting hedges:

Loss recognized in CAF income (3)	$	$ (1)	$	$ (2)

(1)Represents the effective portion.

(2)Represents the ineffective portion.

(3)Represents the loss on interest rate swaps, the net periodic settlements and accrued interest.

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

Level 2Inputs 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 3Inputs that are significant to the measurement that are not observable in the market and include management's judgments about the assumptions market participants would use in pricing the asset or liability (including assumptions about risk).

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

Valuation Methodologies

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

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

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

We measure derivative fair values assuming that the unit of account is an individual derivative instrument and that derivatives are sold or transferred on a stand-alone basis. We estimate the fair value of our derivatives using quotes determined by the derivative counterparties and third-party valuation services. Quotes from third-party valuation services and quotes received from bank counterparties project future cash flows and discount the future amounts to a present value using market-based expectations for interest rates and the contractual terms of the derivative instruments. The models do not require significant judgment and model inputs can typically be observed in the liquid market; however, because the models include inputs other than quoted prices in active markets, all derivatives are classified as Level 2.

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

Items Measured at Fair Value on a Recurring Basis

	As of November 30, 2013					
(In thousands)	Level 1		Level 2		Total	
Assets:						
Money market securities	$ 682,266		$		$ 682,266	
Mutual fund investments	5,821				5,821	
Total assets at fair value	$ 688,087		$		$ 688,087	
Percent of total assets at fair value	100.0	%		%	100.0	%
Percent of total assets	6.1	%		%	6.1	%
Liabilities:						
Derivative instruments	$		$ 2,889		$ 2,889	
Total liabilities at fair value	$		$ 2,889		$ 2,889	
Percent of total liabilities		%		%		%

	As of February 28, 2013					
(In thousands)	Level 1		Level 2		Total	
Assets:						
Money market securities	$ 461,260		$		$ 461,260	
Mutual fund investments	4,024				4,024	
Total assets at fair value	$ 465,284		$		$ 465,284	
Percent of total assets at fair value	100.0	%		%	100.0	%
Percent of total assets	4.7	%		%	4.7	%
Liabilities:						
Derivative instruments	$		$ 517		$ 517	
Total liabilities at fair value	$		$ 517		$ 517	
Percent of total liabilities		%		%		%

7.Income Taxes

We had $28.3 million of gross unrecognized tax benefits as of November 30, 2013, and $25.1 million as of February 28, 2013. There were no significant changes to the gross unrecognized tax benefits as reported for the year ended February 28, 2013, as all activity was related to positions taken on tax returns filed or intended to be filed in the

current fiscal year.

8.Retirement Plans

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

Components of Net Pension Expense

(In thousands)	Three Months Ended November 30					
	Pension Plan		Restoration Plan		Total	
	2013	2012	2013	2012	2013	2012
Interest cost	$ 1,896	$ 1,825	$ 128	$ 115	$ 2,024	$ 1,940
Expected return on plan assets	(1,979)	(1,898)			(1,979)	(1,898)
Recognized actuarial loss	418	300			418	300
Net pension expense	$ 335	$ 227	$ 128	$ 115	$ 463	$ 342

(In thousands)	Nine Months Ended November 30					
	Pension Plan		Restoration Plan		Total	
	2013	2012	2013	2012	2013	2012
Interest cost	$ 5,687	$ 5,475	$ 325	$ 345	$ 6,012	$ 5,820
Expected return on plan assets	(5,937)	(5,694)			(5,937)	(5,694)
Recognized actuarial loss	1,255	900			1,255	900
Net pension expense	$ 1,005	$ 681	$ 325	$ 345	$ 1,330	$ 1,026

We made no contributions to the pension plan during the nine months ended November 30, 2013, and anticipate making no contributions during the remainder of fiscal 2014. The expected long-term rate of return on plan assets for the pension plan was 7.75% as of February 28, 2013.

9.Debt

(In thousands)	As of November 30 2013	As of February 28 2013
Short-term revolving credit facility	$ 1,287	$ 355
Current portion of finance and capital lease obligations	17,837	16,139
Current portion of non-recourse notes payable	214,535	182,915
Total current debt	233,659	199,409
Finance and capital lease obligations, excluding current portion	320,791	337,452
Non-recourse notes payable, excluding current portion	6,755,534	5,672,175
Total debt, excluding current portion	7,076,325	6,009,627

Total debt	$ 7,309,984	$ 6,209,036

Revolving Credit Facility. Our $700 million unsecured revolving credit facility (the "credit facility") expires in August 2016. Borrowings under the credit facility are available for working capital and general corporate purposes. Borrowings accrue interest at variable rates based on LIBOR, the federal funds rate, or the prime rate, depending on the type of borrowing, and we pay a commitment fee on the unused portions of the available funds. As of November 30, 2013, the remaining capacity was fully available to us.

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

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

As of November 30, 2013, $6.16 billion of non-recourse notes payable was outstanding related to term securitizations. These notes payable accrue interest at fixed rates and have scheduled maturities through April 2020, but may mature earlier or later, depending upon the repayment rate of the underlying auto loan receivables.

As of November 30, 2013, $807.0 million of non-recourse notes payable was outstanding related to our warehouse facilities. The combined warehouse facility limit was $1.8 billion, and unused warehouse capacity totaled $993.0 million. During the third quarter of fiscal 2014, we increased our $900 million warehouse facility that is scheduled to expire in February 2014 to $1.0 billion. Of the combined warehouse facility limit, $1.0 billion will expire in February 2014 and $800 million will expire in August 2014. The notes payable outstanding related to our warehouse facilities do not have scheduled maturities, instead the principal payments depend upon the repayment rate of underlying auto loan receivables. The return requirements of the investors could fluctuate significantly depending on market conditions. Therefore, at renewal, the cost, structure and capacity of the facilities could change. These changes could have a significant impact on our funding costs.

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

Financial Covenants. The credit facility agreement contains representations and warranties, conditions and covenants. We must also meet financial covenants in conjunction with certain of the sale-leaseback transactions. Our securitization agreements contain representations and warranties, financial covenants and performance triggers. As of November 30, 2013, we were in compliance with all financial covenants and our securitized receivables were in compliance with the related performance triggers.

10.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. Purchases may be made in open market or privately negotiated transactions at management's discretion and the timing and amount of repurchases are determined based on share price, market conditions, legal requirements and other factors. Shares repurchased are deemed authorized but unissued shares of common stock.

For the three months ended November 30, 2013, we repurchased 313,042 shares of common stock at an average purchase price of $47.39 per share. For the nine months ended November 30, 2013, we repurchased 4,305,293 shares of common stock at an average purchase price of $43.69 per share. For the three and nine months ended November 30, 2012, we repurchased 1,744,300 shares of common stock at an average purchase price of $34.53 per share. As of November 30, 2013, $400.0 million was available for repurchase under the authorization, which expires on December 31, 2014.

(B)Stock Incentive Plans

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

The majority of associates who receive share-based compensation awards primarily receive cash-settled restricted stock units. Senior management and other key associates receive awards of nonqualified stock options and stock-settled restricted stock units. Nonemployee directors receive awards of nonqualified stock options and stock grants.

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

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

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

(C)Share-Based Compensation

Composition of Share-Based Compensation Expense

	Three Months Ended November 30		Nine Months Ended November 30	
(In thousands)	2013	2012	2013	2012
Cost of sales	$ 1,037	$ 1,111	$ 2,896	$ 2,208
CarMax Auto Finance income	790	716	2,302	1,845
Selling, general and administrative expenses	15,371	14,821	50,608	43,304
Share-based compensation expense, before income taxes	$ 17,198	$ 16,648	$ 55,806	$ 47,357

Composition of Share-Based Compensation Expense – By Grant Type

	Three Months Ended November 30		Nine Months Ended November 30	
(In thousands)	2013	2012	2013	2012
Nonqualified stock options	$ 5,946	$ 4,564	$ 18,765	$ 18,805
Cash-settled restricted stock units	8,014	9,238	25,986	17,630
Stock-settled restricted stock units	2,986	2,589	9,697	9,612
Employee stock purchase plan	252	257	858	760
Stock grants to non-employee directors			500	550
Share-based compensation expense, before income taxes	$ 17,198	$ 16,648	$ 55,806	$ 47,357

We recognize compensation expense for stock options and MSUs on a straight-line basis (net of estimated forfeitures) over the requisite service period, which is generally the vesting period of the award. The variable expense associated with RSUs is recognized over their vesting period (net of estimated forfeitures) and is calculated based on the volume-weighted average price of our common stock on the last trading day of each reporting period. The total costs for matching contributions for our employee stock purchase plan are included in share-based compensation expense. There were no capitalized share-based compensation costs as of or for the nine months ended November 30, 2013 or 2012.

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 February 28, 2013	10,771	$ 23.00		
Options granted	1,605	42.77		
Options exercised	(1,328)	19.60		
Options forfeited or expired	(19)	26.25		
Outstanding as of November 30, 2013	11,029	$ 26.29	3.7	$ 272,568
Exercisable as of November 30, 2013	6,854	$ 20.68	2.7	$ 207,819

For the nine months ended November 30, 2013 and 2012, we granted nonqualified options to purchase 1,605,149 and 2,252,124 shares of common stock, respectively. The total cash received as a result of stock option exercises for the nine months ended November 30, 2013 and 2012, was $26.0 million and $37.8 million, respectively. We settle stock option exercises with authorized but unissued shares of our common stock. The total intrinsic value of options exercised for the

nine months ended November 30, 2013 and 2012, was $34.7 million and $37.7 million, respectively. We realized related tax benefits of $13.9 million and $15.1 million during the nine months ended November 30, 2013 and 2012, respectively.

Outstanding Stock Options

(Shares in thousands) Range of Exercise Prices	As of November 30, 2013 Options Outstanding Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Options Exercisable Number of Shares	Weighted Average Exercise Price
$ 11.43	1,627	2.4	$ 11.43	1,627	$ 11.43
$ 13.19 - $ 19.82	2,268	1.3	$ 16.35	2,268	$ 16.35
$ 19.98 - $ 25.39	1,677	3.2	$ 25.19	1,318	$ 25.13
$ 25.67 - $ 32.05	2,147	5.2	$ 31.60	657	$ 31.39
$ 32.69 - $ 49.25	3,310	5.3	$ 37.50	984	$ 32.82
Total	11,029	3.7	$ 26.29	6,854	$ 20.68

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

The weighted average fair value per share at the date of grant for options granted during the nine months ended November 30, 2013 and 2012, was $15.59 and $12.67, respectively. The unrecognized compensation costs related to nonvested options totaled $37.8 million as of November 30, 2013. These costs are expected to be recognized on a straight-line basis over a weighted average period of 2.2 years.

Assumptions Used to Estimate Option Values

	Nine Months Ended November 30 2013	2012
Dividend yield	0.0 %	0.0 %
Expected volatility factor (1)	27.9 % - 46.8 %	31.1 % - 51.4 %
Weighted average expected volatility	44.7 %	49.4 %

Risk-free interest rate (2)	0.02 % - 2.6 %	0.02 % - 2.0 %
Expected term (in years) (3)	4.7	4.7

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

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

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

Cash-Settled Restricted Stock Unit Activity

(Units in thousands)	Number of Units	Weighted Average Grant Date Fair Value
Outstanding as of February 28, 2013	1,651	$ 29.90
Stock units granted	542	$ 42.68
Stock units vested and converted	(564)	$ 25.62
Stock units cancelled	(78)	$ 34.76
Outstanding as of November 30, 2013	1,551	$ 35.68

For the nine months ended November 30, 2013 and 2012, we granted RSUs of 541,819 units and 644,232 units, respectively. The initial weighted average fair market value per unit at the date of grant for the RSUs granted during the nine months ended November 30, 2013 and 2012, was $42.68 and $31.76, respectively. The RSUs are cash-settled upon vesting. For the nine months ended November 30, 2013 and 2012, we paid $23.3 million and $18.0 million, respectively (before payroll tax withholdings), to RSU holders upon the vesting of RSUs. We realized tax benefits of $9.3 million and $7.2 million during the nine months ended November 30, 2013 and 2012, respectively.

Expected Cash Settlement Range Upon Restricted Stock Unit Vesting

	As of November 30, 2013	
(In thousands)	Minimum (1)	Maximum (1)
Fiscal 2015	$ 11,276	$ 30,069
Fiscal 2016	12,422	33,126
Fiscal 2017	14,159	37,757
Total expected cash settlements	$ 37,857	$ 100,952

(1)Net of estimated forfeitures.

Stock-Settled Restricted Stock Unit Activity

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

Outstanding as of February 28, 2013	904	$ 40.78
Stock units granted	238	$ 52.02
Stock units vested and converted	(282)	$ 36.56
Stock units cancelled	(4)	$ 46.14
Outstanding as of November 30, 2013	856	$ 45.26

For the nine months ended November 30, 2013 and 2012, we granted MSUs of 237,660 units and 348,551 units, respectively. The weighted average fair value per unit at the date of grant for MSUs granted during the nine months ended November 30, 2013 and 2012, was $52.02 and $40.33, respectively. The fair values were determined using a Monte-Carlo simulation and were based on the expected market price of our common stock on the vesting date and the expected number of converted common shares. We realized related tax benefits of $6.7 million and $9.5 million for the nine months ended November 30, 2013 and 2012, respectively, from the vesting of market stock units. The unrecognized compensation costs related to nonvested MSUs totaled $16.2 million as of November 30, 2013. These costs are expected to be recognized on a straight-line basis over a weighted average period of 1.3 years.

11.Net Earnings per Share

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

Basic and Dilutive Net Earnings Per Share Reconciliations

	Three Months Ended November 30		Nine Months Ended November 30	
(In thousands except per share data)	2013	2012	2013	2012
Net earnings	$ 106,452	$ 94,681	$ 393,377	$ 327,063
Weighted average common shares outstanding	223,259	228,904	223,831	228,346
Dilutive potential common shares:				
Stock options	3,402	3,210	3,305	3,199
Stock-settled restricted stock units	756	542	734	503
Weighted average common shares and dilutive potential common shares	227,417	232,656	227,870	232,048
Basic net earnings per share	$ 0.48	$ 0.41	$ 1.76	$ 1.43
Diluted net earnings per share	$ 0.47	$ 0.41	$ 1.73	$ 1.41

Certain weighted-average options to purchase shares of common stock were outstanding and not included in the calculation of diluted net earnings per share because their inclusion would have been antidilutive. For the three months ended November 30, 2013 and 2012, weighted-average options to purchase 1,309,282 shares and 3,794,317 shares of common stock, respectively, were not included. For the nine months ended November 30, 2013 and 2012, weighted-average options to purchase 1,175,274 shares and 3,833,199 shares, respectively, were not included.

12.Accumulated Other Comprehensive Loss

Changes in Accumulated Other Comprehensive Loss by Component

	Net Unrecognized Actuarial	Net Unrecognized	Total Accumulated Other Comprehensive

(In thousands, net of income taxes)	Losses	Hedge Losses	Loss
Balance as of February 28, 2013	$ (49,479)	$ (10,329)	$ (59,808)
Other comprehensive loss before reclassifications	(287)	(2,467)	(2,754)
Amounts reclassified from accumulated other comprehensive loss	788	4,647	5,435
Other comprehensive income	501	2,180	2,681
Balance as of November 30, 2013	$ (48,978)	$ (8,149)	$ (57,127)

Changes In and Reclassifications Out of Accumulated Other Comprehensive Loss

(In thousands)	Three Months Ended November 30 2013	2012	Nine Months Ended November 30 2013	2012
Retirement Benefit Plans (Note 8):				
Actuarial loss arising during the year	$ (458)	$ -	$ (458)	$ -
Tax benefit	171	-	171	-
Actuarial loss arising during the year, net of tax	(287)	-	(287)	-
Actuarial loss amortization reclassifications recognized in net pension expense:				
Cost of sales	166	$ 119	500	356
CarMax Auto Finance income	9	7	28	22
Selling, general and administrative expenses	243	174	727	522
Total amortization reclassifications recognized in net pension expense	418	300	1,255	900
Tax expense	(156)	(112)	(467)	(263)
Amortization reclassifications recognized in net pension expense, net of tax	262	188	788	637
Net change in retirement benefit plan unrecognized actuarial losses, net of tax	(25)	188	501	637
Cash Flow Hedges (Note 5):				
Effective portion of changes in fair value	(7,421)	(894)	(4,069)	(7,286)
Tax benefit (1)	2,922	351	1,602	11,377
Effective portion of changes in fair value, net of tax	(4,499)	(543)	(2,467)	4,091
Reclassifications to CarMax Auto Finance income	2,155	3,327	7,665	9,855
Tax expense	(849)	(1,306)	(3,018)	(3,869)
Reclassification of hedge losses, net of tax	1,306	2,021	4,647	5,986
Net change in cash flow hedge unrecognized losses, net of tax	(3,193)	1,478	2,180	10,077
Total other comprehensive (loss) income, net of tax	$ (3,218)	$ 1,666	$ 2,681	$ 10,714

(1)As disclosed in our third quarter filing on Form 10-Q for fiscal 2013, the nine months ended November 30, 2012, included a tax benefit adjustment of $8,518 related to prior years.

Changes in the funded status of our retirement plans and the effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in accumulated other comprehensive loss. The cumulative balances are net of deferred taxes of $34.2 million as of November 30, 2013, and $35.9 million as of February 28, 2013.

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 involved: (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/California’s Labor Code Private Attorney

General Act. The putative class consisted of sales consultants, sales managers, and other hourly employees who worked for the company in California from April 2, 2004, to the present. On May 12, 2009, the court dismissed all of the class claims with respect to the sales manager putative class. On June 16, 2009, the court dismissed all claims related to the failure to comply with the itemized employee wage statement provisions. The court also granted CarMax's motion for summary adjudication with regard to CarMax's alleged failure to pay overtime to the sales consultant putative class. The plaintiffs appealed the court's ruling regarding the sales consultant overtime claim. On May 20, 2011, the California Court of Appeal affirmed the court's ruling in favor of CarMax. The plaintiffs filed a Petition of Review with the California Supreme Court, which was denied. As a result, the plaintiffs' overtime claims are no longer part of the case.

The claims currently remaining in the lawsuit regarding the sales consultant putative class are: (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 (3) unfair competition/California's Labor Code Private Attorney General Act. On June 16, 2009, the court entered a stay of these claims pending the outcome of a California Supreme Court case involving unrelated third parties but related legal issues. Subsequently, CarMax moved to lift the stay and compel the plaintiffs' remaining claims into arbitration on an individualized basis, which the court granted on November 21, 2011. Plaintiffs filed an appeal with the California Court of Appeal. On March 26, 2013, the California Court of Appeal reversed the trial court's order granting CarMax's motion to compel arbitration. On October 8, 2013, CarMax filed a petition for a writ of certiorari seeking review in the United States Supreme Court. The Fowler 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 these matters.

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 effect, either individually or in the aggregate, on our financial condition, results of operations or cash flows.

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 28, 2013 (“fiscal 2013”), as well as our consolidated financial statements and the accompanying notes included in Item 1 of this Form 10-Q. Note references are to the notes to consolidated financial statements included in Item 1. All references to net earnings per share are to diluted net earnings per share. Amounts and percentages may not total due to rounding.

In this discussion, “we,” “our,” “us,” “CarMax,” “CarMax, Inc.” and “the company” refer to CarMax, Inc. and its wholly owne subsidiaries, unless the context requires otherwise.

BUSINESS OVERVIEW

General

CarMax is the nation’s largest retailer of used vehicles. 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 superstores.

We pioneered the used car superstore concept, opening our first store in 1993. Our strategy is to revolutionize 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, 2013, we operated 126 used car superstores in 63 markets, comprising 47 mid-sized markets, 13 large markets and 3 small markets. We define mid-sized markets as those with television viewing populations generally between 600,000 and 2.5 million people. We also operated four new car franchises. During fiscal 2013, we sold 447,728 used cars, representing 98% of the total 455,583 vehicles we sold at retail.

We believe the CarMax consumer offer is distinctive within the auto 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 features low, no haggle prices; a broad selection of CarMax Quality Certified used vehicles; and

superior customer service. Our website, carmax.com, is a valuable tool for communicating the CarMax consumer offer, as well as a sophisticated search engine and efficient channel for customers who prefer to start their shopping online. Our financial results are driven by retailing used vehicles and associated items including vehicle financing, extended service plans ("ESPs"), guaranteed asset protection ("GAP") and vehicle repair service. GAP is designed to cover the unpaid balance on an auto loan in the event of a total loss of the vehicle or unrecovered theft.

We seek to build customer satisfaction by offering high-quality retail vehicles. Fewer than half of the vehicles acquired from consumers through the appraisal purchase process meet our standards for reconditioning and subsequent retail sale. Those vehicles that do not meet our standards are sold through our on-site wholesale auctions. Vehicles repossessed and liquidated by CAF also are generally sold through our wholesale auctions. Wholesale auctions are generally held on a weekly or bi-weekly basis, and as of November 30, 2013, we conducted auctions at 57 used car superstores. During fiscal 2013, we sold 324,779 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.

We sell ESPs and GAP on behalf of unrelated third parties who are the primary obligors. We have no contractual liability to the customer under these third-party plans. ESP revenue represents commissions earned on the sale of ESPs and GAP from the unrelated third parties.

We provide financing to qualified retail customers through CAF and our arrangements with several industry-leading financial institutions. Depending on the credit profile of the customer, the third-party finance providers generally either pay us or are

paid a fixed, pre-negotiated fee per contract. The fee amount is independent of any finance term offered to the customer; it does not vary based on the amount financed, the term of the loan, the interest rate or the loan-to-value ratio. We refer to the providers who pay us a fee as prime and nonprime providers, and we refer to the providers to whom we pay a fee as subprime providers. We periodically test additional third-party providers. We have no recourse liability for credit losses on retail installment contracts arranged with third-party providers.

We offer financing through CAF to qualified customers purchasing vehicles at CarMax. CAF utilizes proprietary customized scoring models based upon the credit history of the customer, along with CAF's historical experience, to predict the likelihood of customer repayment. CAF offers customers an array of competitive rates and terms, allowing them to choose the ones that best fit their needs. In addition, customers are permitted to refinance or pay off their contract with CAF or a third-party provider within three business days of a purchase without incurring any finance or related charges. We randomly test different credit offers and closely monitor acceptance rates, 3-day payoffs and the effect on sales to assess market competitiveness. After the effect of 3 day payoffs and vehicle returns, CAF financed 41% of our retail vehicle unit sales in the first nine months of fiscal 2014. As of November 30, 2013, CAF serviced approximately 514,000 customer accounts in its $6.92 billion portfolio of managed receivables.

Over the long term, we believe the primary driver for earnings growth will be used vehicle unit sales growth from both new stores and stores included in our comparable store base. We also believe that increased used vehicle unit sales will drive increased sales of wholesale vehicles and ancillary products and, over time, CAF income. 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 probability of sale and its mileage relative to its age; however, it is not primarily based on the vehicle's selling price.

In December 2008, we temporarily suspended store growth due to the weak economic and sales environment. We opened 3 superstores in fiscal 2011, 5 superstores in fiscal 2012 and 10 superstores in fiscal 2013. We currently plan to open 13 superstores in fiscal 2014 and between 10 and 15 superstores in each of the following 2 fiscal years. While we currently have more than 120 superstores, we are still in the midst of the national rollout of our retail concept, and as of November 30, 2013, we had used car superstores located in markets that comprised approximately 54% of the U.S. population.

The principal challenges we face in expanding our store base include our ability to build our management bench strength to support our store growth and our ability to procure suitable real estate at favorable terms. We staff each newly opened store with associates who have extensive CarMax training. Therefore, we must recruit, train and develop managers and associates to fill the pipeline necessary to support future store openings.

Fiscal 2014 Third Quarter Highlights

- § Net sales and operating revenues increased 13% to $2.94 billion from $2.60 billion in the third quarter of fiscal 2013. Net earnings grew 12% to $106.5 million from $94.7 million in the prior year period, while net earnings per diluted share grew 15% to $0.47, compared with $0.41 in the prior year period.
- § Total used vehicle revenues increased 16% to $2.40 billion from $2.07 billion in the third quarter of fiscal 2013. Total used vehicle unit sales rose 15%, reflecting the combination of a 10% increase in comparable store used unit sales and sales from newer stores not yet included in the comparable store base.
- § Total wholesale vehicle revenues increased 2% to $437.3 million from $427.7 million in the third quarter of fiscal 2013. Wholesale unit sales rose 4%, reflecting the growth in our store base.
- § Total other sales and revenues declined 5% to $57.2 million from $60.4 million in the third quarter of fiscal 2013, primarily reflecting flat ESP revenues and a reduction in net third-party finance fees. An increase in our allowance for ESP returns of $0.02 per diluted share offset the effect of higher ESP revenues resulting from the growth in retail vehicle sales.
- § Total gross profit increased 11% to $381.7 million compared with $345.2 million in the third quarter of fiscal 2013, largely reflecting the increase in used vehicle unit sales.
- § Selling, general and administrative ("SG&A") expenses increased 11% to $284.4 million from $257.3 million in the third quarter of fiscal 2013. The increase reflected both the 12% increase in our store base since the beginning of last year's third quarter (representing the addition of 13 stores) and higher variable selling costs resulting from the 10% increase in comparable store used unit sales. SG&A per retail unit declined $98 to $2,295 versus $2,393 in the prior year's quarter, as our comparable store used unit sales growth generated overhead leverage.

§ CAF income increased 16% to $83.9 million compared with $72.5 million in the third quarter of fiscal 2013. The improvement resulted from a 24% increase in average managed receivables, partially offset by a lower total interest margin rate, which declined to 6.8% of average managed receivables from 7.4% in the prior year quarter.
§ In the first nine months of the fiscal year, net cash used in operating activities totaled $493.1 million in fiscal 2014, compared with $499.2 million in fiscal 2013. These amounts include increases in auto loan receivables of $1.05 billion and $632.3 million, respectively. The majority of the increases in auto loan receivables are accompanied by increases in non-recourse notes payable, which are separately reflected as cash provided by financing activities. Excluding the increases in auto loan receivables, net cash provided by operating activities would be $552.2 million in the first nine months of fiscal 2014 versus $133.1 million in the first nine months of fiscal 2013, with the increase primarily driven by changes in inventory, accounts payable and net income.

CRITICAL ACCOUNTING POLICIES

For information on 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 28, 2013. These policies relate to financing and securitization transactions, revenue recognition and income taxes.

RESULTS OF OPERATIONS – CARMAX SALES OPERATIONS

Net Sales And Operating Revenues

	Three Months Ended November 30			Nine Months Ended November 30		
(In millions)	2013	2012	Change	2013	2012	Change
Used vehicle sales	$ 2,396.8	$ 2,068.7	15.9 %	$ 7,738.1	$ 6,449.6	20.0 %
New vehicle sales	50.1	45.7	9.6 %	162.5	162.5	0.0 %
Wholesale vehicle sales	437.3	427.7	2.2 %	1,402.8	1,332.5	5.3 %
Other sales and revenues:						
Extended service plan revenues	48.8	48.6	0.3 %	178.4	152.7	16.8 %
Service department sales	26.1	24.8	5.3 %	80.8	76.4	5.8 %
Third-party finance fees, net	(17.7)	(13.1)	(35.3) %	(64.6)	(38.9)	(66.0) %
Total other sales and revenues	57.2	60.4	(5.2) %	194.6	190.2	2.3 %
Total net sales and operating revenues	$ 2,941.4	$ 2,602.4	13.0 %	$ 9,498.0	$ 8,134.9	16.8 %

Unit Sales

Three Months Ended November 30		Nine Months Ended November 30	
2013	2012	2013	2012

Used vehicles	122,065	105,815	394,073	329,422
New vehicles	1,818	1,705	5,954	6,164
Wholesale vehicles	82,743	79,747	262,342	246,059

Average Selling Prices

	Three Months Ended November 30		Nine Months Ended November 30	
	2013	2012	2013	2012
Used vehicles	$ 19,469	$ 19,344	$ 19,480	$ 19,375
New vehicles	$ 27,428	$ 26,681	$ 27,176	$ 26,241
Wholesale vehicles	$ 5,123	$ 5,214	$ 5,185	$ 5,267

Used Vehicle Sales Changes

	Three Months Ended November 30		Nine Months Ended November 30	
	2013	2012	2013	2012
Used vehicle units	15 %	16 %	20 %	9 %
Used vehicle dollars	16 %	17 %	20 %	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 Used Vehicle Sales Changes

	Three Months Ended November 30		Nine Months Ended November 30	
	2013	2012	2013	2012
Used vehicle units	10 %	12 %	14 %	5 %
Used vehicle dollars	10 %	13 %	15 %	6 %

Wholesale Vehicle Sales Changes

	Three Months Ended November 30		Nine Months Ended November 30	
	2013	2012	2013	2012
Wholesale vehicle units	4 %	10 %	7 %	1 %
Wholesale vehicle dollars	2 %	10 %	5 %	0 %

Change in Used Car Superstore Base

	Three Months Ended November 30		Nine Months Ended November 30	
	2013	2012	2013	2012
Used car superstores, beginning of period	123	113	118	108
Superstore openings	3	3	8	8
Used car superstores, end of period	126	116	126	116

Used Vehicle Sales. The 16% increase in used vehicle revenues in the third quarter of fiscal 2014 resulted primarily from a 15% increase in used unit sales. The increase in used unit sales included a 10% increase in comparable store used unit sales and sales from newer stores not yet included in the comparable store base. The comparable store unit growth was primarily driven by improved conversion, as well as a modest increase in store traffic. We believe the strong conversion reflected continued improvements in execution in our stores and an attractive consumer credit environment.

The 20% increase in used vehicle revenues in the first nine months of fiscal 2014 resulted from a 20% increase in used unit sales. The increase in unit sales included a 14% increase in comparable store used unit sales and sales from newer stores not yet included in the comparable store base. The comparable store used unit growth was primarily driven by improved conversion, which we believe, similar to the third quarter, was driven by better in-store execution and the attractive consumer credit environment.

Wholesale Vehicle Sales. Our wholesale auction prices usually reflect the trends in the general wholesale market for the types of vehicles we sell, although they can also be affected by changes in vehicle mix or the average age, mileage or condition of the vehicles bought through our appraisal process and sold in our auctions.

The 2% increase in wholesale vehicle revenues in the third quarter of fiscal 2014 resulted from a 4% increase in wholesale unit sales, partially offset by lower average selling prices. The unit sales increase reflected the growth in our store base. The 5% increase in wholesale vehicle revenues in the first nine months of fiscal 2014 primarily resulted from a 7% increase in wholesale unit sales. Wholesale vehicle unit sales for the first nine months of fiscal 2014 benefited from the growth in our store base and an increase in the appraisal buy rate.

Other Sales and Revenues. Other sales and revenues include commissions on the sale of ESPs and GAP (reported in ESP revenues), service department sales and net third-party finance fees. The fixed, per-vehicle fees paid to us by prime and nonprime third-party finance providers may vary, reflecting the providers' differing levels of credit risk exposure. The fixed, per-vehicle fees that we pay to the subprime providers are reflected as an offset to finance fee revenues received from prime and nonprime providers.

Other sales and revenues declined 5% in the third quarter of fiscal 2014. ESP revenues were similar to the prior year's third quarter, as higher ESP revenues resulting from the growth in our retail vehicle sales were offset by an increase in our allowance for ESP returns of $0.02 per diluted share. The rise in the allowance reflected increases in ESP cancellations prior to the end of their contract term. Net third-party finance fees declined by $4.6 million in the third quarter of fiscal 2014 as the result of a mix shift among providers, including an increase in the percentage of our retail unit sales financed by the subprime providers to

18% in the third quarter of fiscal 2014 from 15% in the prior year period. Over the last two years the volume and share of financings originated by the third-party subprime providers increased, as these providers made more attractive offers. Late in the third quarter of fiscal 2014, however, we began to see tightening of the credit terms offered by our subprime providers. In previous years, the percentage of our retail unit sales financed by subprime providers excluded sales associated with a third-party referral program. These sales are now included in this percentage for both the current and prior periods.

Other sales and revenues increased 2% in the first nine months of fiscal 2014, as higher ESP revenues were largely offset by a decrease in net third-party finance fees resulting from a higher mix of sales financed by the subprime providers. ESP revenues climbed 17% in the first nine months of fiscal 2014, reflecting the 20% growth in used unit sales and higher ESP penetration, partially offset by the increase in the allowance for ESP returns. The percentage of retail sales financed by the subprime providers increased to 19% in the first nine months of fiscal 2014 from 15% in the corresponding period in fiscal 2013. Similar to the third quarter, this increase in mix reflected more attractive offers by subprime providers, as well as a change in credit mix of our applicant flow. In addition, we believe a delay in the 2013 tax refund season shifted the timing of some subprime sales from the fourth quarter of fiscal 2013 to the first quarter of fiscal 2014.

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 new car model year closeouts that can pressure pricing for late-model used vehicles. Customer traffic generally tends to slow in the fall as the weather changes and as customers shift their spending priorities. We typically experience an increase in subprime traffic and sales in February and March, coincident with tax refund season.

Gross Profit

	Three Months Ended November 30			Nine Months Ended November 30		
(In millions)	2013	2012	Change	2013	2012	Change
Used vehicle gross profit	$ 262.4	$ 227.0	15.6 %	$ 859.5	$ 718.2	19.7 %
New vehicle gross profit	1.1	0.9	30.9 %	3.4	4.1	(15.3) %
Wholesale vehicle gross profit	73.4	73.6	(0.2) %	237.4	230.5	3.0 %
Other gross profit	44.8	43.7	2.4 %	164.3	142.3	15.4 %
Total	$ 381.7	$ 345.2	10.6 %	$ 1,264.6	$ 1,095.1	15.5 %

Gross Profit Per Unit

	Three Months Ended November 30		Nine Months Ended November 30	
	2013	2012	2013	2012

	$ per unit(1)	%(2)	$ per unit(1)	%(2)	$ per unit(1)	%(2)	$ per unit(1)	%(2)
Used vehicle gross profit	$ 2,149	10.9	$ 2,146	11.0	$ 2,181	11.1	$ 2,180	11.1
New vehicle gross profit	$ 636	2.3	$ 518	1.9	$ 578	2.1	$ 659	2.5
Wholesale vehicle gross profit	$ 887	16.8	$ 923	17.2	$ 905	16.9	$ 937	17.3
Other gross profit	$ 361	78.3	$ 407	72.4	$ 411	84.4	$ 424	74.8
Total gross profit	$ 3,081	13.0	$ 3,211	13.3	$ 3,161	13.3	$ 3,263	13.5

(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.

Used Vehicle Gross Profit. Used vehicle gross profit increased 16% in the third quarter and 20% in the first nine months of fiscal 2014. In both periods, the improvement was driven by increases in used unit sales. Used vehicle gross profit per unit was consistent year-over-year in both the third quarter and the first nine months of the fiscal year. We have been able to manage to a relatively consistent gross profit per used unit over the last several years.

Wholesale Vehicle Gross Profit. Wholesale vehicle gross profit was similar to the prior year in the third quarter, and it rose 3% in the first nine months of fiscal 2014. In both periods, the increase in wholesale vehicle unit sales was largely offset by a decrease in wholesale vehicle gross profit per unit. Wholesale gross profit per unit declined $36, or 4%, in the third quarter of fiscal 2014, and it fell $32, or 3% in the first nine months of the fiscal year.

Other Gross Profit. Other gross profit includes profits related to ESP and GAP revenues, net third-party finance fees and service department operations. We have no cost of sales related to ESP and GAP revenues or net third-party finance fees, as these represent commissions paid to us by certain third-party providers. Third-party finance fees are reported net of the fees we pay to third-party subprime finance providers. Accordingly, changes in the relative mix of the other gross profit components can affect the composition and amount of other gross profit.

Other gross profit increased 2% in the third quarter of fiscal 2014, reflecting the flat ESP revenues and the decrease in net third-party finance fees, as well as higher service department profits. Other gross profit increased 15% in the first nine months of fiscal 2014, as increases in ESP and service department gross profits were partially offset by the reduction in net third-party finance fees. The higher service department profits in both the third quarter and first nine months of fiscal 2014 was primarily due to the leverage of service overhead costs resulting from strong used unit sales growth.

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

Selling, General and Administrative Expenses

Components of SG&A Expense

	Three Months Ended November 30			Nine Months Ended November 30		
(In millions, except per unit data)	2013	2012	Change	2013	2012	Change
Compensation and benefits (1)	$ 161.4	$ 144.0	12.1 %	$ 494.4	$ 427.1	15.8 %
Store occupancy costs	53.9	51.1	5.4 %	160.9	149.8	7.4 %
Advertising expense	23.4	22.5	3.7 %	77.0	76.7	0.3 %
Other overhead costs (2)	45.7	39.7	15.2 %	125.5	112.0	12.2 %
Total SG&A expenses	$ 284.4	$ 257.3	10.5 %	$ 857.8	$ 765.6	12.0 %
SG&A per unit	$ 2,295	$ 2,393	$ (98)	$ 2,144	$ 2,281	$ (137)

(1)Excludes compensation and benefits related to reconditioning and vehicle repair service, which is included in cost of sales.

(2)Includes IT expenses, insurance, non-CAF bad debt, travel, preopening and relocation costs, charitable contributions and other administrative expenses.

SG&A expenses increased 11% in the third quarter of fiscal 2014. The increase reflected both the 12% increase in our store base since the beginning of last year's third quarter (representing the addition of 13 stores) and higher variable selling costs resulting from the 10% increase in comparable store used unit sales. SG&A per retail unit declined $98, as our comparable store used unit growth generated overhead leverage.

SG&A expenses increased 12% in the first nine months of fiscal 2014. Similar to the third quarter, the increase reflected the growth in our store base, which increased from 108 used car superstores as of the beginning of fiscal 2013 to 126 stores as of November 30, 2013, and higher variable costs associated with the 14% increase in comparable store used unit sales in the first nine months of the year and. Leverage resulting from our strong growth in comparable store used unit sales drove a $137 decrease in SG&A per retail unit in the first nine months of fiscal 2014.

Income Taxes. The effective income tax rate was 38.5% in the third quarter and 38.3% in the first nine months of fiscal 2014 versus 37.9% and 38.2%, respectively, in the corresponding prior year periods.

RESULTS OF OPERATIONS – CARMAX AUTO FINANCE INCOME

CAF provides financing to qualified customers purchasing vehicles at CarMax. Because the purchase of a vehicle is generally 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 the company's processes and systems, transparency of pricing, vehicle quality and the integrity of the information collected at the time the customer applies for credit provide a unique and ideal environment in which to procure high quality auto loans, both for CAF and for the third-party finance providers.

We believe CAF enables us to capture additional sales, profits and cash flows while managing our reliance on third-party finance sources. Management regularly analyzes CAF's operating results by assessing the competitiveness of our consumer offer, profitability, the performance of the auto loan receivables including trends in credit losses and delinquencies, and CAF direct expenses.

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. 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 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.

Components of CAF Income

	Three Months Ended November 30				Nine Months Ended November 30			
(In millions)	2013	% (1)	2012	% (1)	2013	% (1)	2012	% (1)
Interest margin:								
Interest and fee income	$ 138.3	8.1	$ 125.1	9.1	$ 409.0	8.4	$ 368.9	9.3
Interest expense	(22.2)	(1.3)	(23.3)	(1.7)	(67.6)	(1.4)	(72.4)	(1.8)
Total interest margin	116.1	6.8	101.8	7.4	341.4	7.0	296.5	7.5
Provision for loan losses	(19.7)	(1.2)	(18.1)	(1.3)	(49.0)	(1.0)	(40.2)	(1.0)
Total interest margin after provision for loan losses	96.4	5.7	83.7	6.1	292.4	6.0	256.3	6.5
Other income			0.2		0.1			
Direct expenses:								
Payroll and fringe benefit expense	(5.6)	(0.3)	(5.2)	(0.4)	(16.7)	(0.3)	(15.9)	(0.4)
Other direct expenses	(6.9)	(0.4)	(6.2)	(0.5)	(20.5)	(0.4)	(17.1)	(0.4)
Total direct expenses	(12.5)	(0.7)	(11.4)	(0.8)	(37.2)	(0.8)	(33.0)	(0.8)
CarMax Auto Finance income	$ 83.9	4.9	$ 72.5	5.3	$ 255.3	5.2	$ 223.3	5.7
Total average managed receivables	$ 6,805.3		$ 5,477.4		$ 6,491.4		$ 5,266.0	

(1)Annualized percent of total average managed receivables.

CAF Origination Information

	Three Months Ended November 30 (1)		Nine Months Ended November 30 (1)	
	2013	2012	2013	2012
Net loans originated (in millions)	$ 960.6	$ 856.2	$ 3,168.7	$ 2,465.4
Vehicle units financed	50,326	44,338	164,771	128,386
Penetration rate (2)	40.6 %	41.2 %	41.2 %	38.3 %
Weighted average contract rate	7.0 %	7.7 %	6.9 %	8.2 %
Weighted average term (in months)	65.2	66.5	65.5	66.0

(1)All information relates to loans originated net of estimated 3-day payoffs and vehicle returns.

(2)Vehicle units financed as a percentage of total retail units sold.

CAF income increased 16% in the third quarter and 14% in the first nine months of fiscal 2014. Compared with the prior year, CAF's average managed receivables increased 24% in the third quarter and 23% in the first nine months of fiscal 2014, driven by the rise in CAF loan originations in recent years. The rise in originations resulted from an increase in CAF's loan penetration rate, retail unit sales growth and higher average amounts financed.

In fiscal 2014, net loans originated increased 12% to $960.6 million in the third quarter and 29% to $3.17 billion in the first nine months of the year. CAF's penetration rate for the third quarter of fiscal 2014 of 40.6% was similar to the third quarter of

fiscal 2013. The penetration rate increased to 41.2% for the first nine months of fiscal 2014, compared to 38.3% in the corresponding period in fiscal 2013, as a result of an increase in the mix of higher credit quality applicants and favorable responses to our credit offers. Starting in mid-fiscal 2013, we began providing more competitive offers in select customer segments.

The effect of the increase in managed receivables on CAF income was partially offset by a lower total interest margin rate, which declined to 6.8% of average managed receivables in the third quarter and 7.0% in the first nine months of fiscal 2014, from 7.4% and 7.5%, respectively, in the prior year periods. The interest margin reflects the spread between interest and fees charged to consumers and our funding costs. Providing more competitive offers in select customer segments contributed to a decline in the weighted average contract rate on originations to 7.0% in the third quarter and 6.9% in the first nine months of fiscal 2014 from 7.7% and 8.2%, respectively, in the corresponding prior year periods. Changes in the interest margin on new originations will affect CAF income over time as these loans become a larger percentage of managed receivables. Rising interest rates or further competitive pressure on consumer rates could result in further compression in the interest margin on new originations.

For the third quarter, the provision for loan losses decreased slightly to 1.2% of average managed receivables in fiscal 2014, compared with 1.3% in fiscal 2013. The provision for loan losses was consistent at 1.0% of average managed receivables in the first nine months of both fiscal 2014 and fiscal 2013. The provision for loan losses is the periodic expense of maintaining an adequate allowance for loan losses.

Allowance for Loan Losses

	Three Months Ended November 30				Nine Months Ended November 30			
(In millions)	2013	% (1)	2012	% (1)	2013	% (1)	2012	% (1)
Balance as of beginning of period	$ 65.9	1.0	$ 49.5	0.9	$ 57.3	1.0	$ 43.3	0.9
Charge-offs	(36.3)		(28.2)		(94.5)		(73.1)	
Recoveries	18.6		14.9		56.1		43.9	
Provision for loan losses	19.7		18.1		49.0		40.2	
Balance as of end of period	$ 67.9	1.0	$ 54.3	1.0	$ 67.9	1.0	$ 54.3	1.0

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

The allowance for loan losses represents an estimate of the amount of net losses inherent in our portfolio of managed receivables as of the applicable reporting date and anticipated to occur during the following 12 months. The allowance is primarily based on the credit quality of the underlying receivables, historical loss trends and forecasted forward loss curves. We consider recent trends in delinquencies and losses, recovery rates and the economic environment. The increase in the dollar amount of the allowance largely reflected the growth in managed receivables. The allowance for loan losses as a percentage of managed receivables was flat at 1.0% as of November

30, 2013 and 2012, respectively.

Past Due Account Information

(In millions)	As of November 30 2013	2012	As of February 28 or 29 2013	2012
Accounts 31+ days past due	$ 201.1	$ 164.9	$ 154.2	$ 116.5
Ending managed receivables	$ 6,919.0	$ 5,583.4	$ 5,933.3	$ 4,981.8
Past due accounts as a percentage of ending managed receivables	2.91 %	2.95 %	2.60 %	2.34 %

Credit Loss Information

(In millions)	Three Months Ended November 30 2013	2012	Nine Months Ended November 30 2013	2012
Net credit losses on managed receivables	$ 17.7	$ 13.3	$ 38.4	$ 29.2
Total average managed receivables	$ 6,805.3	$ 5,477.4	$ 6,491.4	$ 5,266.0
Annualized net credit losses as a percentage of total average managed receivables	1.04 %	0.97 %	0.79 %	0.74 %
Average recovery rate	53.4 %	56.5 %	56.0 %	58.9 %

As of November 30, 2013, past due accounts were 2.91% of ending managed receivables, similar to the delinquency rate as of November 30, 2012. For the third quarter, net credit losses were slightly higher at 1.04% of average managed receivables in fiscal 2014 compared with 0.97% in fiscal 2013. For the first nine months of the year, net credit losses were 0.79% of average managed receivables in fiscal 2014 compared with 0.74% in fiscal 2013.

The average recovery rate represents the average percentage of the outstanding principal balance we receive when a vehicle is repossessed and liquidated, generally at our wholesale auctions. The annual recovery rate has ranged from a low of 42% to a high of 60%, and it is primarily affected by changes in the wholesale market pricing environment.

PLANNED FUTURE ACTIVITIES

Planned Superstore Openings. We plan to open a total of 13 superstores in fiscal 2014 and between 10 and 15 superstores in each of the following 2 fiscal years. We currently estimate capital expenditures will total approximately $300 million in fiscal 2014.

We currently plan to open the following superstores within 12 months from November 30, 2013:

Location	Television Market	Market Status	Planned Opening Date
St. Peters, Missouri (1)	St. Louis	Existing	Q4 Fiscal 2014
Newark, Delaware (1)	Philadelphia	New	Q4 Fiscal 2014
King of Prussia, Pennsylvania (1)	Philadelphia	New	Q4 Fiscal 2014
Frederick, Maryland	Washington/Baltimore	Existing	Q4 Fiscal 2014
Elk Grove, California	Sacramento	Existing	Q4 Fiscal 2014
Rochester, New York	Rochester	New	Q1 Fiscal 2015
Dothan, Alabama	Dothan	New	Q1 Fiscal 2015
Mechanicsburg, Pennsylvania	Harrisburg/Lancaster	Existing	Q1 Fiscal 2015
Spokane, Washington	Spokane	New	Q1 Fiscal 2015
Madison, Wisconsin	Madison	New	Q2 Fiscal 2015
Fort Worth, Texas	Dallas	Existing	Q2 Fiscal 2015
Lynchburg, Virginia	Roanoke/Lynchburg	New	Q2 Fiscal 2015
Milwaukie, Oregon	Portland	New	Q2 Fiscal 2015
Beaverton, Oregon	Portland	New	Q3 Fiscal 2015
Tupelo, Mississippi	Tupelo	New	Q3 Fiscal 2015
Reno, Nevada	Reno	New	Q3 Fiscal 2015
Raleigh, North Carolina	Raleigh	Existing	Q3 Fiscal 2015

(1)Opened in December 2013.

Normal construction, permitting or other scheduling delays could shift the opening dates into a later period.

CarMax Auto Finance. In the fourth quarter of fiscal 2014, CAF plans to launch a test originating loans for customers who typically would be financed by our subprime providers. Given the relevance of subprime to our business and the overall market, we believe it is prudent to gain further insight into underwriting and servicing accounts within this credit profile. Over the next 12 months, we plan to originate approximately $70 million of loans in this test. We expect the loans originated in this test will have higher loss and delinquency rates than the aggregate of the current CAF portfolio. The test will be funded separately from our current portfolio and not included in our current public securitization program.

FINANCIAL CONDITION

Liquidity and Capital Resources.

Our primary ongoing cash requirements are to fund our existing operations, new superstore expansion (including capital expenditures and inventory purchases) and CAF. Our primary ongoing sources of liquidity include existing cash balances, funds provided by operations, proceeds from securitization transactions or other funding arrangements, and borrowings under our revolving credit facility.

Operating Activities. During the first nine months of the fiscal year, net cash used in operating activities totaled $493.1 million in fiscal 2014 versus $499.2 million in fiscal 2013. These amounts include increases in auto loan receivables of $1.05 billion and $632.3 million, respectively. The majority of the increases in auto loan receivables are accompanied by increases in non-recourse notes payable, which are separately reflected as cash provided by financing activities. Excluding the increases in auto loan receivables, net cash provided by operating activities would be $552.2 million in the first nine months of fiscal 2014 versus $133.1 million in the first nine months of fiscal 2013, with the increase primarily driven by changes in inventory, accounts payable and net income.

As of November 30, 2013, total inventory was $1.56 billion, representing an increase of $38.5 million, or 3%, compared with the balance at the start of fiscal 2014. We had 4% more used vehicles in inventory as of November 30, 2013, compared with the start of the fiscal year, reflecting the addition of inventory associated with new stores opened during fiscal 2014. Compared with November 30, 2012, inventories increased $217.2 million, or 16%, reflecting the inventories added to support the 10 new stores opened since that date and our strong comparable store used unit sales growth.

As of November 30, 2013, accounts payable totaled $367.5 million, which was $30.8 million, or 9%, higher than the balance as of the start of fiscal 2014, largely due to the growth in our store base. As of November 30, 2012, accounts payable totaled $272.8 million, which was $52.0 million, or 16%, lower than the balance as of the start of fiscal 2013. The reduction in payables in fiscal 2013 was primarily attributable to the effect of our cash management strategies.

Investing Activities. During the first nine months of the fiscal year, net cash used in investing activities totaled $228.7 million in fiscal 2014 compared with $179.2 million in fiscal 2013. Capital expenditures increased to $212.9 million in fiscal 2014 versus $184.9 million in the prior year period. We opened eight used car superstores during the first nine months of fiscal 2014, including five stores in new markets (Harrisonburg, Virginia; Columbus, Georgia; Savannah, Georgia; Jackson, Tennessee; and St. Louis, Missouri) and three stores in existing markets (Houston, Texas; Sacramento, California; and Baltimore/Washington, D.C.). Capital expenditures primarily include real estate acquisitions for planned future superstore openings and store construction costs. We maintain a multi-year pipeline of sites to support our superstore growth, so portions of capital spending in any one year may relate to superstores that we plan to open in subsequent fiscal years. After ramping superstore growth in recent years, our superstore opening pace has become more consistent, with 10 superstores opened in fiscal 2013, 13 superstores planned for fiscal 2014, and 10 to 15 superstores planned for each of the following 2 fiscal years.

Historically, capital expenditures have been funded with internally generated funds, debt and sale-leaseback transactions. No sale-leasebacks have been completed since fiscal 2009.

As of November 30, 2013, we owned 69 and leased 57 of our 126 used car superstores.

During the first nine months of the fiscal year, restricted cash from collections on auto loan receivables increased $22.5 million in fiscal 2014 versus no material change in fiscal 2013. These collections vary depending on the timing of the receipt of principal and interest payments on securitized auto loan receivables, the change in average managed receivables and the funding vehicle utilized.

Financing Activities. During the first nine months of the fiscal year, net cash provided by financing activities totaled $937.2 million in fiscal 2014 compared with $680.9 million in fiscal 2013. Included in these amounts were net increases in total non-recourse notes payable of $1.11 billion and $696.4 million, respectively, which were used to provide the financing for the majority of the increases of $1.05 billion and $632.3 million, respectively, in auto loan receivables. During the first nine months of the fiscal year, cash provided by financing activities was reduced by $196.7 million of stock repurchases in fiscal 2014, versus $51.1 million in fiscal 2013. We began making repurchases under our share repurchase program in the third quarter of fiscal 2013.

Total Debt and Cash and Cash Equivalents

(In thousands)	As of November 30 2013	As of February 28 2013
Borrowings under revolving credit facility	$ 1,287	$ 355
Finance and capital lease obligations	338,628	353,591
Non-recourse notes payable	6,970,069	5,855,090
Total debt	$ 7,309,984	$ 6,209,036
Cash and cash equivalents	$ 664,758	$ 449,364

We have a $700 million unsecured revolving credit facility, which expires in August 2016. Borrowings under this credit facility are available for working capital and general corporate purposes, and the unused portion is fully available to us. See Note 9 for additional information on the revolving credit facility agreement.

The credit facility agreement contains representations and warranties, conditions and covenants. If these requirements were not met, all amounts outstanding or otherwise owed could become due and payable immediately and other limitations could be placed on our ability to use any available borrowing capacity.

CAF auto loan receivables are primarily funded through securitization transactions. Our securitizations are structured to legally isolate the auto loan receivables, and we would not expect to be able to access the assets of our securitization vehicles, even in insolvency, receivership or conservatorship proceedings. Similarly, the investors in the non-recourse notes payable 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 do, however, continue to have the rights associated with the interest we retain in these securitizations vehicles.

The timing of principal payments on the non-recourse notes payable is based on principal collections, net of losses, on the securitized auto loan receivables. The current portion of the non-recourse notes payable represents principal payments that are due to be distributed in the following period.

As of November 30, 2013, $6.16 billion of non-recourse notes payable was outstanding related to term securitizations. These notes payable accrue interest at fixed rates and have scheduled maturities through April 2020, but may mature earlier or later, depending on the repayment rate of the underlying auto loan receivables. During the first nine months of fiscal 2014, we completed three term securitizations, funding a total of $2.92 billion of auto loan receivables.

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. During the first quarter of fiscal 2014, we exercised this option on a term securitization that had originally been issued in 2009, and for which CarMax had provided $140.0 million of capital, or 14% of the transaction, in the form of subordinated bonds. Upon the exercise of this option, we funded substantially all of the remaining receivables through our warehouse facilities.

As of November 30, 2013, $807.0 million of non-recourse notes payable was outstanding related to our warehouse facilities. At that date, the combined warehouse facility limit was $1.8 billion (including $100 million of warehouse capacity added during the third quarter) and the unused warehouse capacity totaled $993.0 million. Of the combined warehouse facility limit, $1.0 billion will expire in February 2014 and $800 million will expire in August 2014. The

return requirements of the warehouse facility investors could fluctuate significantly depending on market conditions. At renewal, the cost, structure and capacity of the facilities could change. These changes could have a significant effect on our funding costs. See Notes 2 and 9 for additional information on the warehouse facilities.

The securitization agreements related to the warehouse facilities include various representations and warranties, covenants and performance triggers. If these requirements are not met, we could be unable to continue to securitize receivables through the warehouse facilities. In addition, the warehouse facility investors could charge us a higher rate of interest and could have us replaced as servicer. Further, we could be required to deposit collections on the securitized receivables with the warehouse facility agents on a daily basis and deliver executed lockbox agreements to the warehouse facility agents.

We expect that cash generated by operations and proceeds from securitization transactions or other funding arrangements, sale-leaseback transactions and borrowings under existing, new or expanded credit facilities will be sufficient to fund CAF, capital expenditures and working capital for the foreseeable future. We anticipate that we will be able to enter into new, or renew or expand existing, funding arrangements to meet our future funding needs. However, based on conditions in the credit markets, the cost for these arrangements could be materially higher than historical levels and the timing and capacity of these transactions could be dictated by market availability rather than our requirements.

In fiscal 2013, our board of directors authorized the repurchase of up to $800 million of our common stock. Purchases may be made in open market or privately negotiated transactions at management's discretion and the timing and amount of repurchases are determined based on share price, market conditions, legal requirements and other factors. Shares repurchased are deemed authorized but unissued shares of common stock.

During the nine months ended November 30, 2013, we repurchased 4.3 million shares of common stock at an average purchase price of $43.69 per share. As of November 30, 2013, $400.0 million was available for repurchase under the authorization,

expiring on December 31, 2014. Amounts reported as the repurchase and retirement of common stock on our statement of cash flows may reflect timing differences in trade and settlement dates on stock repurchase transactions occurring at the end of a reporting period.

Fair Value Measurements. We report money market securities, mutual fund investments and derivative instruments at fair value. See Note 6 for more information on fair value measurements.

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, expenditures, CAF income, 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 or regional U.S. economic conditions.
§ Changes in the competitive landscape within our industry.
§ Changes in the availability or cost of capital and working capital financing, including changes related to the asset-backed securitization market.
§ Changes in the attractiveness or availability of consumer credit related to our third-party financing providers.
§ Significant changes in retail prices for used and new vehicles.
§ A reduction in the availability of or access to sources of inventory.
§ Factors related to the regulatory and legislative environment in which we operate.
§ Events that damage our reputation or harm the perception of the quality of our brand.
§ Security breaches or other events that result in the misappropriation, loss or other unauthorized disclosure of confidential customer or associate information.
§ Factors related to geographic growth, including the inability to acquire or lease suitable real estate at favorable terms or to effectively manage our growth.
§ The loss of key employees from our store, regional or corporate management teams or a significant increase in labor costs.
§ The failure of key information systems.
§ The effect of various litigation matters.
§ Adverse conditions affecting one or more automotive manufacturers or manufacturer recalls.
§ The occurrence of severe weather events.
§ Factors related to the seasonal fluctuations in our business.
§ Factors related to the geographic concentration of our superstores.
§ The effect of new accounting requirements or changes to U.S. generally accepted accounting principles.
§ Acts of terrorism, the outbreak of war or other significant national or international events.

For more details on factors that could affect expectations, see Part II, Item 1A, "Risk Factors" on Page 38 of this report, our Annual Report on Form 10-K for the fiscal year ended February 28, 2013, and our quarterly or current reports as filed with or furnished to the Securities and Exchange Commission ("SEC"). 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. 4391.

Item 3.Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to our market risk since February 28, 2013. For information on our exposure to market risk, refer to Part II, Item 7A, “Quantitative and Qualitative Disclosures about Market Risk,” contained in our Annual Report on Form 10-K for the year ended February 28, 2013.

Item 4.Controls and Procedures

Disclosure. We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (“Exchange Act”)) that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Our disclosure controls and procedures 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, with the participation of the CEO and CFO, we evaluated the effectiveness of our disclosure controls and procedures. Based upon that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period.

Internal Control over Financial Reporting. There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended November 30, 2013, 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 involved: (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; (5) unfair competition; and (6) California's Labor Code Private Attorney General Act. The putative class consisted of sales consultants, sales managers, and other hourly employees who worked for the company in California from April 2, 2004, to the present. On May 12, 2009, the court dismissed all of the class claims with respect to the sales manager putative class. On June 16, 2009, the court dismissed all claims related to the failure to comply with the itemized employee wage statement provisions. The court also granted CarMax's motion for summary adjudication with regard to CarMax's alleged failure to pay overtime to the sales consultant putative class. The plaintiffs appealed the court's ruling regarding the sales consultant overtime claim. On May 20, 2011, the California Court of Appeal affirmed the ruling in favor of CarMax. The plaintiffs filed a Petition of Review with the California Supreme Court, which was denied. As a result, the plaintiffs' overtime claims are no longer a part of the lawsuit.

The claims currently remaining in the lawsuit regarding the sales consultant putative class are: (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; (3) unfair competition; and (4) California's Labor Code Private Attorney General Act. On June 16, 2009, the court entered a stay of these claims pending the outcome of a California Supreme Court case involving unrelated third parties but related legal issues. Subsequently, CarMax moved to lift the stay and compel the plaintiffs' remaining claims into arbitration on an individual basis, which the court granted on November 21, 2011. The plaintiffs appealed the court's ruling to the California Court of Appeal. On March 26, 2013, the California Court of Appeal reversed the trial court's order granting CarMax's motion to compel arbitration. On October 8, 2013, CarMax filed a petition for a writ of certiorari seeking review in the United States Supreme Court. The Fowler 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 these matters.

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 effect, either individually or in the aggregate, on our financial condition, results of operations or cash flows.

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 28, 2013, should be considered. These risks could materially and adversely affect our business, financial condition, and results of operations. There have been no material changes to the factors discussed in our Form 10 K.

Item 2.Unregistered Sales of Equity Securities and Use of Proceeds

On October 17, 2012, our board of directors authorized the repurchase of up to $300 million of our common stock. The authorization expired on December 31, 2013. In January 2013, our board of directors authorized an additional $500 million for the repurchase of our common stock. This $500 million authorization expires on December 31, 2014. Purchases may be made in open market or privately negotiated transactions at management’s discretion and the timing and amount of repurchases are determined based on share price, market conditions, legal requirements and other factors. Shares repurchased are deemed authorized but unissued shares of common stock.

The following table provides information relating to the company’s repurchase of common stock for the third quarter of fiscal 2014. The table does not include transactions related to employee equity awards or the exercises of employee stock options.

Period			Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
September	1 - 30,	2013	18,123	$ 47.85	18,123	$ 413,968,396
October	1 - 31,	2013	294,919	$ 47.37	294,919	$ 399,999,340
November	1 - 30,	2013	-	$ -	-	$ 399,999,340
Total			313,042		313,042	

Item 4.Mine Safety Disclosures

None.

Item 6.Exhibits

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

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

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

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

101.INSXBRL Instance Document

101.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEFXBRL Taxonomy Extension Definition Linkbase Document

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PREXBRL Taxonomy Extension Presentation Linkbase Document

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/ Thomas W. Reedy
Thomas W. Reedy
Executive Vice President and
Chief Financial Officer

January 8, 2014

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