Analyst Corner

By: Jon Baker, CFA · April 2019

An Introduction to CarMax, Inc. (KMX)

CarMax is the largest used-car retailer in the United States, with a growing network of over 200 locations across 100 television markets. The company spent its first nine years as a subsidiary of parent company, Circuit City, before being spun out on its own in 2002. For both the past 5- and 10-year periods, CarMax has grown its used-vehicle unit sales in excess of 7% compounded (and at a faster pace prior). Despite decades of greater-than-industry growth, the company still sells only a low-single-digit percentage share of U.S. used vehicles up to 10 years old and has a credible glide path to much higher share over the coming years.

Selling used cars is a competitive business, yet CarMax has grown profitably over the decades by disassociating itself from the behaviors that earn used-car dealers their spotty reputations. All vehicle pricing is “no haggle.” CarMax sales associates are paid fixed commissions, regardless of the vehicle sold. Additionally, CarMax makes a cash offer on every car presented at their door, telling consumers, “We’ll buy your car even if you don’t buy ours.” Each piece of their consumer offer–vehicle pricing, trade-in, financing and service plan–competes on its own merit.

Over the past decade, same-store unit sales growth for CarMax stores open one year or more has averaged about +4%. Still, the most recent two-year period has seen the lowest rate of same-store growth since the Great Recession. We see a couple contributing headwinds. First, recent data from Manheim’s wholesale auctions suggests used-vehicle pricing remains near historic highs relative to that of new vehicles. Such a narrow gap between new- and used-vehicle pricing is likely indicative of cyclically aggressive competitive behavior, an issue we’ve seen before and that we expect will again revert to CarMax’s benefit.

Second, we have seen the growth of online offerings such as that of Carvana. Though selling only about one-seventh of CarMax’s recent volumes, Carvana is growing rapidly and has likely taken some wind out of CarMax’s sails in common markets. Admittedly later to the e-commerce game, CarMax has spent the past few years developing an online buying option to enhance its best-in-class physical store experience. We believe the resultant physical-online hybrid will be a step-change improvement in an already advantaged CarMax consumer experience, allowing CarMax to serve the greatest percentage of shoppers in the manner of their choice. Crucially, this evolution rides the same rail of customer primacy CarMax has ridden since the opening of its first store in 1993.

Already shipping upwards of 2 million vehicles per year within its network, CarMax has the procurement heft, refurbishment capacity, IT budget, advertising scale and brand awareness to layer on a compelling e-commerce option for those consumers who prefer it. In testing for the past few years, CarMax’s first commercial omni-channel market was launched in the Atlanta area in December, and these capabilities will roll out to the bulk of their footprint in the coming year.

Early returns from the first live market have been promising, with same-market volumes up double digits. Also encouraging is the way the company talks about future investment. Three customer experience centers will be added this year, each serving multi-state regions and each more efficiently performing work currently tasked to local store associates. The removal of operating expense incurred by physical stores combined with the ability to conduct the entire car-buying experience from home—including test drives, financing and taking delivery of a vehicle—means that future physical consumer “touchpoints” can eventually be far different from those of the legacy store base. Those touchpoints can be much less costly, less time consuming to develop and can quickly allow for a physical presence in new, smaller markets or greater coverage and convenience in existing markets than the legacy store model alone can afford.

This evolution may begin to take some wind from Carvana’s sails, or it may not. But with a combined low-single-digit share of used-vehicle sales between them, it may not matter. By better adapting their physical presence to consumers’ evolving preferences and by pressing the advantages a national network confers, we believe the other 95%+ of the market can keep both companies happy and growing for many years to come. Carvana has burned cash every year of its existence, including over half a billion dollars in 2018 alone. We have opted instead for the long-profitable CarMax, trading at 14 times forward earnings and buying back its undervalued shares. We value CarMax in the low-to-mid $90s per share.

Jon Baker, CFA, *joined Weitz Investment Management, Inc. in 1997. Prior to joining Weitz, Jon audited equity funds as a certified public accountant at McGladrey & Pullen. He holds a bachelor’s degree in accounting and computer applications from the University of Notre Dame. Jon has been a CFA® charterholder since 2001.*

As of March 31, 2019, each of the following portfolio companies constituted a portion of the net assets of Value Fund, Partners Value Fund, Partners III Opportunity Fund, and Hickory Fund as follows: CarMax, Inc. 3.9%, 3.9%, 2.8%, and 3.3%. Current and future portfolio holdings are subject to risk.

Investors should consider carefully the investment objectives, risks, and charges and expenses of the Funds before investing. The Funds’ Prospectus contains this and other information about the Funds and should be read carefully before investing. The Prospectus is available from Weitz Investment Management, Inc. Weitz Securities, Inc. is the distributor of the Weitz Funds.