

COPART INC  
Form 10-Q  
December 10, 2008  
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## **UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549



# FORM 10-Q



(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
for the quarterly period ended October 31, 2008

**OR**

**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: 0-23255

**COPART, INC.**

(Exact name of registrant as specified in its charter)





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**California**  
(State or other jurisdiction  
of incorporation or organization)

**94-2867490**  
(I.R.S. Employer  
Identification Number)

**4665 Business Center Drive, Fairfield, CA 94534**

(Address of principal executive offices with zip code)

Registrant's telephone number, including area code: **(707) 639-5000**

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  NO

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

Number of shares of Common Stock outstanding as of December 9, 2008: 83,341,375

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**Copart, Inc.**

**Index to the Quarterly Report**

**October 31, 2008**

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Copart, Inc.****Consolidated Balance Sheets****(in thousands)****(Unaudited)**

	<b>October 31, 2008</b>	<b>July 31, 2008</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 50,770	\$ 38,954
Accounts receivable, net	118,508	111,705
Vehicle pooling costs	32,475	30,787
Inventories	4,329	5,334
Income taxes receivable	7,264	19,041
Prepaid expenses and other assets	7,538	6,932
Total current assets	220,884	212,753
Property and equipment, net	514,908	510,340
Intangibles, net	17,024	21,901
Goodwill	165,366	177,164
Deferred income taxes	6,010	6,938
Land purchase options and other assets	25,370	27,151
Total assets	\$ 949,562	\$ 956,247
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 77,329	\$ 88,883
Book overdraft	7,579	17,502
Deferred revenue	15,409	14,518
Income taxes payable	10,692	4,005
Deferred income taxes	3,854	2,768
Other current liabilities	576	576
Total current liabilities	114,863	128,252
Deferred income taxes	11,197	14,044
Income taxes payable	13,545	12,219
Other liabilities	2,829	2,736
Total liabilities	142,434	157,251
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value - 180,000 shares authorized; 83,337 and 83,275 shares issued and outstanding at October 31, 2008 and July 31, 2008, respectively	318,844	316,673

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Accumulated other comprehensive income (loss)	(30,460)	833
Retained earnings	518,744	481,490
Total shareholders' equity	807,128	798,996
Total liabilities and shareholders' equity	\$ 949,562	\$ 956,247

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Copart, Inc.****Consolidated Statements of Income****(in thousands except per share amounts)****(Unaudited)**

	<b>Three months ended October 31,</b>	
	<b>2008</b>	<b>2007</b>
Revenues	\$ 191,569	\$ 183,957
Operating costs and expenses:		
Yard operations	111,999	105,565
General and administrative	20,085	21,765
Total operating costs and expenses	132,084	127,330
Operating income	59,485	56,627
Other income:		
Interest income, net	581	2,743
Other income	1,254	796
Total other income	1,835	3,539
Income before income taxes	61,320	60,166
Income taxes	24,066	22,556
Net income	\$ 37,254	\$ 37,610
Earnings per share-basic		
Basic net income per share	\$ 0.45	\$ 0.42
Weighted average common shares outstanding	83,283	88,558
Earnings per share-diluted		
Diluted net income per share	\$ 0.44	\$ 0.41
Weighted average common shares and dilutive potential common shares outstanding	85,320	90,686

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Copart, Inc.****Consolidated Statements of Cash Flows****(in thousands)****(Unaudited)**

	<b>Three Months Ended October 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 37,254	\$ 37,610
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,709	11,004
Allowance for doubtful accounts	(56)	35
Deferred rent	(73)	12
Share-based compensation	1,500	2,061
Loss(gain) on sale of property and equipment	527	(27)
Deferred income taxes	1,721	(1,948)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(8,828)	(5,593)
Vehicle pooling costs	(2,521)	(889)
Inventory	225	(1,623)
Prepaid expenses and other current assets	(1,020)	439
Land purchase options and other assets	(276)	(458)
Accounts payable and accrued liabilities	(8,308)	(5,650)
Deferred revenue	921	253
Income taxes receivable	11,777	3,208
Income taxes payable	8,812	17,258
Net cash provided by operating activities	52,364	55,692
<b>Cash flows from investing activities:</b>		
Purchases of short-term investments		(154,360)
Sales of short-term investments		256,985
Restricted cash		9,148
Purchases of property and equipment	(29,200)	(19,911)
Proceeds from sale of property and equipment	165	97
Purchases of assets and liabilities in connection with acquisition, net of cash acquired		(10,086)
Net cash provided by (used in) investing activities	(29,035)	81,873
<b>Cash flows from financing activities:</b>		
Proceeds from the exercise of stock options	620	7,507
Excess tax benefit from share-based payment arrangements	54	5,540
Change in book overdraft	(9,923)	(1,784)
Net cash provided by (used in) financing activities	(9,249)	11,263
Effect of exchange rate changes on cash	(2,264)	877
Net increase in cash and cash equivalents	11,816	149,705
Cash and cash equivalents at beginning of period	38,954	107,621
Cash and cash equivalents at end of period	\$ 50,770	\$ 257,326

**Supplemental disclosure of cash flow information:**

Income taxes paid	\$	2,016	\$	415
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See accompanying notes to unaudited consolidated financial statements.



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**Copart, Inc.**

**Notes to Consolidated Financial Statements**

October 31, 2008

(Unaudited)

**NOTE 1 Description of Business and Summary of Significant Accounting Policies**

*Description of Business*

Copart, Inc. (the Company) provides vehicle sellers with a full range of remarketing services to process and sell vehicles over the Internet through the Company's Virtual Bidding Second Generation (VB2) Internet auction-style sales technology. Sellers are primarily insurance companies but also include banks and financial institutions, charities, car dealerships, fleet operators, vehicle rental companies and the general public. The Company sells principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters; however at certain locations, the Company sells directly to the general public. The majority of the vehicles sold on behalf of the insurance companies are either damaged vehicles deemed a total loss or not economically repairable by the insurance companies or are recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. The Company offers vehicle sellers a full range of remarketing services that expedite each stage of the vehicle sales process, minimize administrative and processing costs and maximize the ultimate sales price. In the United States, or US, the Company sells vehicles primarily as an agent and derives revenue primarily from fees paid by vehicle sellers and vehicle buyers as well as related fees for services such as towing and storage. In the United Kingdom, or UK, the Company operates primarily on a principal basis, purchasing the salvage vehicle outright from the insurance companies and reselling the vehicle for its own account.

*Principles of Consolidation*

The consolidated financial statements of the Company include the accounts of the parent company and its wholly owned subsidiaries, including its foreign wholly-owned subsidiaries, Copart Canada, Inc. (Copart Canada) and Copart UK Limited (Copart UK). Significant intercompany transactions and balances have been eliminated in consolidation. Copart Canada was incorporated in January 2003 and Copart UK was incorporated in June 2007. Investments in companies with respect to which the Company exercises significant influence but does not control (generally 20% to 50% ownership interest), are accounted for under the equity method of accounting.

In the opinion of the management of the Company, the accompanying unaudited consolidated financial statements contain all adjustments (which are normal recurring accruals) necessary to present fairly its financial position as of October 31, 2008 and July 31, 2008, and its consolidated statements of income and cash flows for the three months ended October 31, 2008 and October 31, 2007. Interim results for the three months ended October 31, 2008 are not necessarily indicative of the results that may be expected for any future period, nor for the entire year ending July 31, 2009. These consolidated financial statements have been prepared in accordance with the rules and regulations of the US Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with US generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The interim financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2008.

*Use of Estimates*

The preparation of financial statements in conformity with US generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used for, but not limited to, vehicle pooling costs, self-insured reserves, allowance for doubtful accounts, income taxes, revenue recognition, share-based compensation, long-lived asset impairment calculations and contingencies. Actual results could differ from those estimates.

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***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company adopted the provisions of Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* (FIN 48), as of August 1, 2007. For benefits to be realized, a tax position must be more likely than not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that has a greater than 50 percent likelihood of being realized upon settlement.

***Foreign Currency Translation***

The functional currency of the Company is the US dollar. The Canadian dollar and the British pound are the functional currencies of the Company's foreign subsidiaries, Copart Canada and Copart UK, respectively, as they are the primary currencies within the economic environment in which each subsidiary operates. The original equity investment in the respective subsidiaries is translated at historical rates. Assets and liabilities of the respective subsidiary's operations are translated into US dollars at period-end exchange rates, and revenues and expenses are translated into US dollars at average exchange rates in effect during each reporting period. Adjustments resulting from the translation of each subsidiary's financial statements are reported in other comprehensive income.

***Revenue Recognition***

The Company provides a portfolio of services to its sellers and buyers that facilitate the sale and delivery of a vehicle from seller to buyer. These vehicle remarketing services include the ability to use its Internet sales technology and vehicle delivery, loading, title processing, preparation and storage. The Company evaluates multiple-element arrangements relative to the Company's buyer and seller agreements in accordance with Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), which addresses accounting for multiple-element arrangements, and Staff Accounting Bulletin No. 104 *Revenue Recognition* (SAB104), which addresses revenue recognition for units of accounting.

The remarketing services the Company provides to the seller of a vehicle involve disposing of a vehicle on the seller's behalf and, under most of the Company's current North American contracts, collecting the proceeds from the buyer. The Company is not entitled to any seller fees until the Company has collected the sales proceeds from the buyer for the seller and, accordingly, the Company recognizes revenue for seller services after service delivery and cash collection.

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In certain cases, seller fees are not contingent upon collection of the seller proceeds from the buyer. However, the Company has determined that it is not able to separate the services into separate units of accounting because the Company does not have fair value for undelivered items. As a result, the Company does not recognize seller fees until the final seller service has been delivered, which occurs upon collection of the sales proceeds from the buyer for the seller.

Vehicle sales, where the Company purchases and remarkets vehicles on its own behalf, are recognized in accordance with SAB 104 on the sale date, which is typically the point of high bid acceptance. Upon high bid acceptance, a legal binding contract is formed with the buyer, and the Company records the gross sales price as revenue.

The Company provides a number of services to the buyer of the vehicle, charging a separate fee for each service. Each of these services has been assessed under the criteria of EITF 00-21 to determine whether the Company has met the requirements to separate the services into units of accounting within a multi-element arrangement. The Company has concluded that the sale service and the post-sale services are separate units of accounting. The fees for the auction service are recognized upon completion of the sale, and the fees for the post-sale services are recognized upon successful completion of those services using the residual method.

The Company also charges buyers an annual registration fee for the right to participate in its vehicle sales program, which is recognized ratably over the term of the arrangement, and relist and late-payment fees, which are recognized upon

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receipt of payment by the buyer. No provision for returns has been established, as all sales are final with no right of return, although the Company provides for bad debt expense in the case of non-performance by its sellers.

**NOTE 2 Cash and Cash Equivalents**

On August 1, 2008, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157), which clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level I) observable inputs such as quoted prices in active markets; (Level II) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level III) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures its investments and marketable securities at fair value. Cash and cash equivalents are classified within Level I of the fair value hierarchy because they are valued using quoted market prices.

As of October 31, 2008, cash and cash equivalents include the following (in thousands):

	Cost	Unrealized Gains	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Longer	Estimated Fair Value
Cash	\$ 27,303	\$	\$	\$	\$ 27,303
Money market funds	23,467				23,467
Total	\$ 50,770	\$	\$	\$	\$ 50,770

The Company invests its excess funds in money market funds comprised of securities issued by corporations, banks, municipalities and financial holding companies. The Company's cash and cash equivalents are placed with high credit quality financial institutions. Additionally, the Company diversifies its investment portfolio in order to maintain safety and liquidity and it does not hold auction-rate or mortgage-backed securities.

**NOTE 3 Vehicle Pooling Costs**

The Company defers in vehicle pooling costs certain yard and fleet expenses associated with vehicles consigned to and received by the Company but not sold as of the balance sheet date. The Company quantifies the deferred costs using a calculation that includes the number of vehicles at its facilities at the beginning and end of the period, the number of vehicles sold during the period and an allocation of certain yard operation costs of the period. The primary expenses allocated and deferred are certain facility costs, labor, transportation, and vehicle processing. If the allocation factors change, then yard operation expenses could increase or decrease correspondingly in the future. These costs are expensed as vehicles are sold in the subsequent periods on an average cost basis.

**NOTE 4 Net Income Per Share**

There were no adjustments to net income in calculating diluted net income per share. The table below reconciles basic weighted shares outstanding to diluted weighted average shares outstanding (in thousands):

	<b>Three Months Ended October 31,</b>	
	<b>2008</b>	<b>2007</b>
Basic weighted average shares outstanding	83,283	88,558
Effect of dilutive securities - stock options	2,037	2,128
Diluted weighted average shares outstanding	85,320	90,686

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Options to purchase 40,000 and 970,000 shares of common stock at a weighted average price of \$40.44 and \$34.39 per share were outstanding during the three months ended October 31, 2008 and 2007, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common stock during the respective periods and including these options would have an anti-dilutive impact.

**NOTE 5 Goodwill and Intangible Assets**

The following table sets forth amortizable intangible assets by major asset class as of the dates indicated (in thousands):

	October 31, 2008		July 31, 2008
Amortized intangibles:			
Covenants not to compete	\$ 10,697	\$	10,697
Supply contracts	20,598		25,239
Software	685		840
Licenses and databases	317		388
Accumulated amortization	(15,273)		(15,263)
Net intangibles	\$ 17,024	\$	21,901

Aggregate amortization expense on amortizable intangible assets was \$1.2 million and \$1.4 million for the three months ended October 31, 2008 and 2007, respectively.

The change in the carrying amount of goodwill is as follows (in thousands):



Balance as of July 31, 2008	\$	177,164
Goodwill recorded during the period		
Effect of foreign currency exchange rates		(11,798)
Balance as of October 31, 2008	\$	165,366

**NOTE 6 Share-Based Compensation**

Effective August 1, 2005, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), requiring it to recognize expense related to the fair value of its share-based compensation awards. The Company elected to use the modified prospective transition method as permitted by SFAS 123(R). Under this transition method, share-based compensation expense for the three-month periods ended October 31, 2008 and October 31, 2007 include compensation expense for all share-based compensation awards granted prior to, but not yet vested, as of August 1, 2005, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123 Accounting for Stock-Based Compensation, net of estimated forfeitures. Share-based compensation expense for all stock-based compensation awards granted subsequent to August 1, 2005 was based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). For options issued subsequent to August 1, 2005, the Company recognizes compensation expense for stock option awards on a straight-line basis over the requisite service period of the award. For options issued prior to August 1, 2005, the Company recognizes compensation expense for stock option awards on a graded vesting basis over the requisite service period of the award.

The following is a summary of option activity for the Company's stock option plans:

	Shares (in 000s)	Weighted- average Exercise Price	Weighted-average Remaining Contractual Term	Aggregate Intrinsic Value (in 000s)
Outstanding at July 31, 2008	4,791	\$ 19.41		
Grants of options	215	\$ 39.55		
Exercises	(14)	\$ 20.93		
Forfeitures or expirations	(6)	\$ 26.38		
Outstanding at October 31, 2008	4,986	\$ 20.27	5.22	\$ 74,162
Exercisable at October 31, 2008	3,482	\$ 15.08	3.80	\$ 69,008

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The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the 4,945,645 options that were in-the-money at October 31, 2008.

In September 2007, James Grosfeld and Harold Blumenstein, who served as members of the Company's Board of Directors since 1993 and 1994, respectively, resigned from the Board to pursue other business and personal interests. In connection with their resignations, the Board of Directors exercised its discretion pursuant to the terms of the 2001 Stock Option Plan to accelerate the vesting of all unvested shares of the Company's common stock subject to options held by Mr. Grosfeld and Mr. Blumenstein. As of September 6, 2007, Mr. Grosfeld and Mr. Blumenstein each held options to acquire 86,000 shares of common stock, of which 14,316 per director were unvested. In addition, the board approved amendments to outstanding option agreements with Mr. Grosfeld and Mr. Blumenstein to extend the period in which they will be able to exercise their options following their resignation until the earlier of September 14, 2012 or the date the option would otherwise have terminated by its terms assuming they had continued to serve as members of the board of directors. As a result of the amendment to the outstanding option agreements, the Company recognized a share-based compensation expense of approximately \$1.0 million during the quarter ended October 31, 2007.

**NOTE 7 Common Stock Repurchases**

In October 2007, the Company's Board of Directors approved a 20 million share increase in the Company's stock repurchase program, bringing the total current number of shares authorized for repurchase to 29 million shares. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. Subject to applicable securities laws, such repurchases will be made at such times and in such amounts as the Company deems appropriate and may be discontinued at any time. The Company did not repurchase any shares during the three months ended October 31, 2008 and 2007. The total number of shares repurchased under the program as of October 31, 2008 was approximately 14 million, leaving approximately 15 million available for repurchase by the Company under the repurchase program.

**NOTE 8 Segments and Other Geographic Reporting**

Operating segments are defined as components of a business about which separate financial information is available that is evaluated regularly by the chief operating decision maker with respect to the allocation of resources and performance. The Company considers itself as operating in a single operating segment, specifically providing vehicle sellers with a full range of remarketing services to process and sell vehicles over the Internet through the Company's Virtual Bidding Second Generation (VB2) Internet auction-style sales technology.

The following geographic data is provided in accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. Revenues are based upon the geographic location of the selling facility and are summarized in the following table (in thousands):

	<b>Three Months Ended October 31,</b>	
	<b>2008</b>	<b>2007</b>
United States	\$ 150,872	\$ 138,901
Canada	1,283	1,274
North America	152,155	140,175

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United Kingdom		39,414		43,782
	\$	191,569	\$	183,957

Long-lived assets based upon geographic location are summarized in the following table (in thousands):

	<b>Three Months Ended October 31,</b>	
	<b>2008</b>	<b>2007</b>
United States	\$ 587,071	\$ 516,589
Canada	5,125	6,212
North America	592,196	522,801
United Kingdom	136,482	147,377
	\$ 728,678	\$ 670,178

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The following table reconciles net income to comprehensive income (in thousands):

	<b>Three Months Ended October 31,</b>	
	<b>2008</b>	<b>2007</b>
Net income, as reported	\$ 37,254	\$ 37,610
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of tax effects	(31,293)	4,134
Comprehensive income	\$ 5,961	\$ 41,744

**NOTE 10 Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosure about fair value measurements. In February 2008, the FASB issued FASB Staff Position (FSP) SFAS No. 157-2 *Effective Date of FASB Statement No. 157* (FSP 157-2) which delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statement on a recurring basis (at least annually). FSP 157-2 partially defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FSP 157-2. The Company adopted SFAS No. 157, except as it applies to those non-financial assets and non-financial liabilities as noted in FSP 157-2. The partial adoption of SFAS No. 157 did not have an impact on the Company's consolidated results or financial condition.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 was effective as of the beginning of the Company's 2009 fiscal year, and the Company did not elect to measure any financial instruments and other items at fair value pursuant to SFAS 159.

In December 2007, the EITF issued Issue No. 07-1, *Accounting for Collaborative Arrangements* (EITF 07-1). EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. EITF 07-1 requires that transactions with third parties (i.e., revenue generated and costs incurred by the partners) should be reported in the appropriate line item in each company's financial statement pursuant to the guidance in EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. EITF 07-1 also includes enhanced disclosure requirements regarding the nature and purpose of the arrangement, rights and obligations under the arrangement, accounting policy, amount and income statement classification of collaboration transactions between the parties. The Company is currently evaluating the impact that EITF 07-1 will have on its consolidated results of operations and financial position.

In December 2007, the (FASB) issued SFAS No. 141(R), *Business Combinations*, (SFAS 141(R)) which provides revised guidance on the accounting for acquisitions of businesses. This standard changes the current guidance to require that all acquired assets, liabilities, minority interest and certain contingencies be measured at fair value, and certain other acquisition-related costs be expensed rather than capitalized. SFAS 141(R) will apply to the Company's acquisitions that are effective after July 31, 2009, and application of the standard to acquisitions prior

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to that date is not permitted. In the event of an acquisition, the Company will need to evaluate whether or not SFAS 141(R) will have a material impact on its consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, (SFAS 160), which provides guidance on the presentation of minority interests in the financial statements. This standard requires that minority interest be presented as a component of equity rather than as a mezzanine item between liabilities and equity, and also requires that minority interests be presented as a separate caption in the income statement. This standard also requires all transactions with minority interest holders, including the issuance and repurchase of minority interests, be accounted for as equity transactions unless a change in control of the subsidiary occurs. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the potential impact on its consolidated results of operations and financial position.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under SFAS 161, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 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. SFAS 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS 133 for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is currently assessing the potential impact on its consolidated results of operations and financial position.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and early adoption is prohibited. The Company is currently assessing the potential impact on its consolidated results of operations and financial position.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS 162 will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company is currently assessing the potential impact on its consolidated results of operations and financial position.

In October 2008, the FASB issued FSP SFAS 157-3, *Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active* (FSP 157-3), to clarify how an entity would determine fair value in an inactive market. FSP 157-3 is effective immediately and applies to the Company's October 31, 2008 financial statements. The application of the provisions of FSP 157-3 did not impact the Company's consolidated financial position, results of operations and cash flows as of and for the three month period ended October 31, 2008.

**NOTE 11 Legal Proceedings**

The Company is involved in litigation and damage claims arising in the ordinary course of business, such as actions related to injuries, property damage, and handling or disposal of vehicles. This litigation includes the following matters:

On November 20, 2007, Car Auction & Reinsurance Solutions, Inc. (CARS) filed suit against the Company in the Superior Court in the County of New Castle, Delaware. CARS is seeking in excess of \$2 million in damages, punitive damages, and prejudgment interest related to allegations involving breach of contract and misrepresentation. The Company believes the claim is without merit and is defending the lawsuit vigorously.

On November 30, 2007, Tracy Utterback Suggs filed suit against the Company in Harris County, Texas District Court. The complaint alleges breach of contract and negligence for allowing Suggs' vehicle to be destroyed. The plaintiff claims that the vehicle in question was the key piece

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of evidence in support of an anticipated design defect products liability case against American Honda and that the Company is responsible for the spoliation of that evidence. On May 28, 2008, the parties reached a settlement in principle at mediation. The settlement does not result in any material contribution on the part of the Company because its insurance company agreed to fund the settlement, under a reservation of rights. All portions of the settlement requiring court approval have been approved and the case has now been fully settled. The Company is aware, however, that the insurance company intends to claim that the Company is responsible for a \$2 million self-insured retention. The Company cannot determine that a loss is probable, and it cannot reasonably estimate the amount of a loss regarding this claim, if a claim is made. The Company intends to vigorously defend any claim made by the insurance company.

On April 18, 2007, Heather Trafton, as personal representative of the estate of Larry Trafton, filed a wrongful death suit against Carlos Sigas Star Auto and the Company in the Circuit Court of the Thirteenth Judicial Circuit of Florida in the County of Hillsborough, Florida. The plaintiff alleges that Manuel Vega, a driver for the independent tow company Carlos Sigas Star Auto, caused the death of decedent, motorcyclist Larry Trafton, by running a red light and colliding with Mr. Trafton at an intersection. Although neither Mr. Sigas nor Mr. Vega are employees of the Company, the plaintiff alleges that

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the Company is responsible for the wrongful death of Mr. Trafton. On or about February 6, 2008, the Company received the plaintiff's initial monetary demand in the amount of \$6 million. On September 16, 2008, the parties reached a settlement in principle at mediation. On October 13, 2008, the final settlement was approved by the court. The settlement did not result in any material contribution on the part of the Company.

On July 14, 2008, the Company filed a lawsuit against Auto Auction Services Corp. (AASC) in US District Court, Northern District of California. The principal parties are the Company as plaintiff and AASC as defendant. The complaint identified, but did not name as defendants, various co-conspirators, including Manheim Auctions, Inc. and ADESA, Inc. The complaint primarily alleges that AASC and its co-conspirators engaged in a group boycott and concerted refusal to deal with the Company for the purpose of excluding it from effectively providing vehicle auction services to fleet operators, fleet management companies, national or regional banks, finance companies, and leasing companies, all in violation of federal and California antitrust and unfair competition laws. The Company is seeking injunctive relief and unspecified monetary damages.

The Company provides for costs relating to these matters when a loss is probable and the amount can be reasonably estimated. The effect of the outcome of these matters on the Company's future results of operations cannot be predicted because any such effect depends on future results of operations and the amount and timing of the resolution of such matters. The Company believes that any ultimate liability will not have a material effect on its financial position, results of operations or cash flows. However, the amount of the liabilities associated with these claims, if any, cannot be determined with certainty. The Company maintains insurance which may or may not provide coverage for claims made against us. There is no assurance that there will be insurance coverage available when and if needed or that the Company's insurers will not seek to deny or limit coverage. Additionally, the insurance that the Company carries requires that the Company pay for costs or claims exposure up to the amount of the insurance deductibles negotiated when insurance is purchased.

**NOTE 12 Income Taxes**

The Company adopted the provisions of FIN 48, as of August 1, 2007. For benefits to be realized, a tax position must be more likely than not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement.

As of October 31, 2008, the total gross unrecognized tax benefits increased by \$1.3 million from \$12.2 million to \$13.5 million.

Over the next twelve months, the Company's existing positions will continue to generate an increase in liabilities for unrecognized tax benefits, as well as a likely decrease in liabilities of up to \$2.8 million as a result of the lapse of the applicable statute of limitations and the conclusion of income tax audits. The decrease in FIN 48 liabilities will have a positive effect on the Company's consolidated results of operations and financial position when realized.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. The amount of interest and penalties accrued at October 31, 2008 was approximately \$0.3 million.



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The Company files income tax returns in the US federal jurisdiction, various states, Canada and the United Kingdom. The Company is currently under audit by the Internal Revenue Service, State of New York, State of Connecticut and State of California. With some exceptions, the Company is no longer subject to US federal, state and local, or non-US income tax examinations by tax authorities for years prior to fiscal year 2005. The Company expects the commencement of certain state tax audits in the near term. At this time, the Company does not believe that the outcome of any examination will have a material impact on the Company's consolidated results of operations and financial position.

The Company has not provided US federal income and foreign withholding taxes from undistributed earnings of its foreign operations, including Copart UK, because it plans to permanently reinvest the earnings of its foreign operations as of October 31, 2008. If these earnings were distributed, foreign tax credits may become available under current law to reduce or eliminate the resultant U.S. income tax liability.

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**NOTE 13 Credit Facility**

On March 6, 2008, the Company entered into an unsecured credit agreement with Bank of America, N.A. (the Credit Agreement) providing for a \$200 million revolving credit facility (the Credit Facility), including a \$100 million foreign currency borrowing sublimit and a \$50 million letter of credit sublimit. Amounts borrowed under the Credit Facility may be used for repurchases of stock, capital expenditures, working capital and other general corporate purposes. The Credit Facility matures and all outstanding borrowings are due on the fifth anniversary of the Credit Agreement (the Maturity Date), with annual reductions in availability of \$25 million on each of the first three anniversaries of the Credit Agreement. Amounts borrowed under the Credit Facility may be repaid and re-borrowed until the Maturity Date and bear interest, at the Company's option, at either Eurocurrency Rate plus 0.5% to 0.875%, depending of the leverage ratio, as defined in the Credit Agreement, at the end of the previous quarter or at the prime rate. A default interest rate applies on all obligations during an event of default under the Credit Facility at a rate per annum equal to 2.0% above the otherwise applicable interest rate. The Credit Facility requires the Company to pay a commitment fee on the unused portion of the Credit Facility. The commitment fee ranges from 0.075% to 0.15% depending on the leverage ratio as of the end of the previous quarter. The Credit Facility contains customary representations and warranties and places certain business operating restrictions on the Company relating to, among other things, indebtedness, liens and other encumbrances, investments, mergers and acquisitions, asset sales, and dividends, distributions and redemptions of capital stock. In addition, the Credit Agreement provides for a maximum total leverage ratio and a minimum interest coverage ratio. The Credit Facility contains events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, cross-defaults to certain other indebtedness, bankruptcy and insolvency defaults, material judgments, invalidity of the loan documents and events constituting a change of control. The Credit Facility is guaranteed by the Company's material domestic subsidiaries. As of October 31, 2008, the Company did not have an outstanding balance under the Credit Facility.

**NOTE 14 Reclassifications**

The Company has determined that in the first quarter of fiscal 2008, it included \$3.0 million in general and administrative costs and \$0.4 million in general and administrative depreciation from the Copart UK operations that, in order to be consistent with US classification, should have been reflected in yard operations. The reclassifications of these costs, which have no effect on fiscal 2009, are reflected in the fiscal 2008 results.

The Company reclassified \$4.6 million from other long-term assets to deferred income taxes for the period ended July 31, 2008, to conform to the current year presentation.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Quarterly Report on Form 10-Q, including the information incorporated by reference herein, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended, (the Exchange Act). All statements other than statements of historical facts are statements that could be deemed forward-looking statements. In some cases, you can identify forward-looking statements by terms such as may, will, should, expect, plan, intend, forecast, anticipate, believe, estimate, predict, potential, continue or the negative of these terms or other comparable terminology. The forward-looking statements contained in this Form 10-Q involve known and unknown risks, uncertainties and situations that may cause our or our industry's actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. These forward-looking statements are made in reliance upon the safe harbor provision of the Private Securities Litigation Reform Act of 1995. These factors include those listed in Part I, Item 1A. Risk Factors of this Form 10-Q and those discussed elsewhere in this Form 10-Q. We encourage investors to review these factors carefully together with the other matters referred to herein, as well as in the other documents we file with the Securities and Exchange Commission, or SEC. The Company may from time to time make additional written and oral forward-looking statements, including statements contained in the Company's filings with the SEC. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.*

*Although we believe that, based on information currently available to the Company and its management, the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. In addition, historical information should not be considered an indicator of future performance.*

**Overview**



We provide vehicle sellers with a full range of remarketing services to process and sell vehicles primarily over the Internet through our Virtual Bidding Second Generation Internet auction-style sales technology, which we refer to as VB2. Sellers are primarily insurance companies but also include banks and financial institutions, charities, car dealerships, fleet operators, vehicle rental companies and the general public. We sell principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters; however at certain locations, we sell directly to the general public. The majority of the vehicles sold on behalf of the insurance companies are either damaged vehicles deemed a total loss or not economically repairable by the insurance companies or are recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. We offer vehicle sellers a full range of remarketing services that expedite each stage of the salvage vehicle sales process and minimize administrative and processing costs. In the United States, or US, we sell vehicles primarily as an agent and derive revenue primarily from fees paid by vehicle sellers and vehicle buyers as well as related fees for services such as towing and storage. In the United Kingdom, or UK, we operate primarily on a principal basis, purchasing the salvage vehicle outright from the insurance companies and reselling the vehicle for our own account.

Our revenues consist of sales transaction fees charged to vehicle sellers and vehicle buyers, transportation revenue and purchased vehicle revenues. Revenues from sellers are generally generated either on a fixed fee contract basis where we collect a fixed amount for selling the vehicles regardless of the selling price of the vehicle or, under our Percentage Incentive Program, or PIP program, our fees are generally based on a predetermined percentage of the vehicle sales price. Under the fixed fee program, we generally charge an additional fee for title processing and special preparation. Although sometimes included in the consignment fee, we may also charge additional fees for the cost of transporting the vehicle to our facility, storage of the vehicle, and other incidental costs. Under the consignment programs, only the fees associated with vehicle processing are recorded in revenue, not the actual sales price (gross proceeds). Sales transaction fees also include fees charged to vehicle buyers for purchasing vehicles, storage and annual registration. Transportation revenue includes charges to sellers for towing vehicles under certain contracts. Transportation revenue also includes towing charges assessed to buyers for delivering vehicles. Purchased vehicle revenue includes the gross sales price of the vehicle which we have purchased or are otherwise considered to own and is primarily generated in the UK.

Operating costs consist primarily of operating personnel (which includes yard management, clerical and yard employees), rent, contract vehicle towing, insurance, fuel, equipment maintenance and repair, and costs of vehicles we sold under purchase contracts. Because we operate as a principal in the UK, purchasing and reselling salvaged vehicles for our own account, we expect operating costs to increase as a percentage of revenue in future periods. Costs associated with general and administrative expenses consist primarily of executive management, accounting, data processing, sales personnel, human resources, professional fees, research and development and marketing expenses.

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During fiscal 2004 and fiscal 2008, we converted all of our North American and United Kingdom vehicle remarketing facilities, respectively, to an Internet-based auction-style model using our VB2 Internet sales technology. This process employs a two-step bidding process. The first step, called the preliminary bid, allows buyers to submit bids up to one hour before a real time virtual auction begins. The second step allows buyers to bid against each other, and the high bidder from the preliminary bidding process, in a real-time process over the Internet.

**Acquisitions and New Operations**



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We have experienced significant growth as we have acquired sixteen vehicle storage facilities and established eleven new facilities since the beginning of fiscal 2007. All of these acquisitions have been accounted for using the purchase method of accounting.

As part of our overall expansion strategy of offering integrated services to vehicle sellers, we anticipate acquiring and developing facilities in new regions, as well as the regions currently served by our facilities. As part of this strategy, in the first quarter of fiscal 2009, we opened two new facilities located in Louisville, Kentucky and Richmond, Virginia. In fiscal 2008, we acquired eight new facilities in the UK located in Peterlee; Wisbech; Rochford; York; Inverkeithing; Whitburn; Featherstone; and Doncaster and in North America, we acquired one facility in Sikeston, Missouri and opened six new facilities in London, Ontario; Windsor, New Jersey; Walton, Kentucky; Birmingham, Alabama; Minneapolis, Minnesota and Prairie Grove, Arkansas. In fiscal 2007, we acquired seven new facilities in the UK located in Sandy; Sandtoft; Sandwich; Westbury; Chester; Denny; and Wootton and in North America we opened three new facilities in Baltimore, Maryland; Woodburn, Oregon; and Punta Gorda, Florida. The Denny, Doncaster and Featherstone facilities were closed prior to July 31, 2008. We believe that these acquisitions and openings strengthen our coverage as we have 145 facilities located in North America and the United Kingdom and are able to provide national coverage for our sellers.

In April 2008, we completed the acquisition of Simpson Bros. (York) Holdings Limited, a United Kingdom limited liability company (Simpson), which operates one location in York, England. Simpson's primary business activity was the dismantling of automobiles and the sales of salvaged auto parts. In the same month, we also completed the acquisition of Bob Lowe Salvage Pool, Inc., which operates one location in Sikeston, Missouri. In February 2008, we completed the purchase of the assets and business of AG Watson Auto Salvage & Motors Spares (Scotland) Limited (AG Watson) which operates two salvage locations in Scotland and two salvage locations in northern England. In August 2007, we completed the acquisition of Century Salvage Sales Limited (Century), a vehicle salvage disposal company with three facilities located in the UK. The total consideration paid for these acquisitions consisted of approximately \$38.2 million in cash, net of cash acquired.

On June 14, 2007, we acquired all the issued share capital of Universal Salvage plc, or Universal, for £2.00 per share (approximately \$3.94 based on currency exchange rates on June 14, 2007). Universal, based in the UK and operating exclusively within the UK, is a service provider to the motor insurance and automotive industries. The aggregate acquisition consideration paid by us totaled approximately £60.7 million (approximately \$120.0 million based on currency exchange rates on June 14, 2007) and was funded from our available cash resources. We also assumed outstanding indebtedness of Universal totaling approximately £2.3 million (\$4.5 million as of June 14, 2007). The acquisition was our first acquisition outside North America and included the seven facilities discussed above.

The period-to-period comparability of our operating results and financial condition is substantially affected by business acquisitions, new openings, weather and product introductions during such periods. In particular, the UK acquisition, both because of its size and because the UK operates primarily on the principal model versus the agency model employed in the United States, will have a significant impact on the comparability of revenues and gross margin percentages in future periods.

In addition to growth through acquisitions, we seek to increase revenues and profitability by, among other things, (i) acquiring and developing new vehicle storage facilities in key markets, (ii) pursuing national and regional vehicle seller agreements, (iii) expanding our service offerings to sellers and buyers, and (iv) expanding the application of VB2 into new markets. In addition, we implement our pricing structure and merchandising procedures and attempt to effect cost efficiencies at each of our acquired facilities by implementing our operational procedures, integrating our management information systems and redeploying personnel, when necessary.

### **Critical Accounting Policies and Estimates**



The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to vehicle pooling costs, self-insured reserves,

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allowance for doubtful accounts, income taxes, revenue recognition, share-based compensation, long-lived asset impairment calculations and contingencies. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management has discussed the selection of critical accounting policies and estimates with the Audit Committee of the Board of Directors and the Audit Committee has reviewed our disclosure relating to critical accounting policies and estimates in this Quarterly Report on Form 10-Q. The following is a summary of the more significant judgments and estimates used in the preparation of our consolidated financial statements:

**Revenue Recognition**



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We provide a portfolio of services to our sellers and buyers that facilitate the sale and delivery of a vehicle from seller to buyer. These services include the ability to use our Internet sales technology and vehicle delivery, loading, title processing, preparation and storage. We evaluate multiple-element arrangements relative to our buyer and seller agreements in accordance with Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), which addresses accounting for multiple-element arrangements, and Staff Accounting Bulletin No. 104, *Revenue Recognition* (SAB 104), which addresses revenue recognition for units of accounting.

The services we provide to the seller of a vehicle involve disposing of a vehicle on the seller's behalf and, under most of our current North American contracts, collecting the proceeds from the buyer. We are not entitled to any such seller fees until we have collected the sales proceeds from the buyer for the seller and, accordingly, we recognize revenue for seller services after service delivery and cash collection.

Vehicle sales, where we purchase and remarket vehicles on our own behalf, are recognized in accordance with SAB 104 on the sale date, which is typically the point of high bid acceptance. Upon high bid acceptance, a legal binding contract is formed with the buyer, and we record the gross sales price as revenue.

In certain cases, seller fees are not contingent upon collection of the seller proceeds from the buyer. However, we determined that we are not able to separate the services into separate units of accounting because we do not have fair value for undelivered items. As a result, we do not recognize seller fees until the final seller service has been delivered, which generally occurs upon collection of the sales proceeds from the buyer for the seller.

We provide a number of services to the buyer of the vehicle, charging a separate fee for each service. Each of these services has been assessed under the criteria of EITF 00-21 to determine whether we have met the requirements to separate them into units of accounting within a multi-element arrangement. We have concluded that the sale and the post-sale services are separate units of accounting. The fees for sale services are recognized upon completion of the sale, and the fees for the post-sale services are recognized upon successful completion of those services using the residual method.

We also charge buyers an annual registration fee for the right to participate in our vehicle sales program, which is recognized ratably over the term of the arrangement, and relist and late-payment fees, which are recognized upon receipt of payment by the buyer. No provision for returns has been established, as all sales are final with no right of return, although we provide for bad debt expense in the case of non-performance by our buyers or sellers.

### **Vehicle Pooling Costs**



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We defer in vehicle pooling costs certain yard operation expenses associated with vehicles consigned to and received by us, but not sold as of the balance sheet date. We quantify the deferred costs using a calculation that includes the number of vehicles at our facilities at the beginning and end of the period, the number of vehicles sold during the period and an allocation of certain yard operation expenses of the period. The primary expenses allocated and deferred are certain facility costs, labor, transportation, and vehicle processing. If our allocation factors change, then yard operation expenses could increase or decrease correspondingly in the future. These costs are expensed as vehicles are sold in the subsequent periods on an average cost basis.

We apply the provisions of Statement of Financial Accounting Standards (SFAS), No. 151, *Inventory Costs* (SFAS 151), to our vehicle pooling costs. SFAS 151 requires that items such as idle facility expense, excessive spoilage, double freight and rehandling costs be recognized as current-period charges regardless of whether they meet the criteria of so abnormal as provided in Accounting Research Bulletin No. 43, Chapter 4, *Inventory Pricing*. In addition, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of production facilities.

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**Allowance for Doubtful Accounts**





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We maintain an allowance for doubtful accounts in order to provide for estimated losses resulting from disputed amounts billed to suppliers or buyers and the inability of our suppliers or buyers to make required payments. If billing disputes exceed expectations and/or if the financial condition of our suppliers or buyers were to deteriorate, additional allowances may be required.

### **Valuation of Goodwill**



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We evaluate the impairment of goodwill of our salvage sales operating segment annually (or on an interim basis if certain indicators are present) by comparing the fair value of the operating segment to its carrying value. Future adverse changes in market conditions or poor operating results of the operating segment could result in an inability to recover the carrying value of the investment, thereby requiring impairment charges in the future.

### **Income Taxes and Deferred Tax Assets**



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We are subject to income taxes in the US, Canada and UK. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Effective August 1, 2008, we adopted Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that has more than 50 percent likelihood of being realized upon settlement.

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

In addition, we are subject to the continuous examination of our income tax returns by various taxing authorities, including the Internal Revenue Service, Inland Revenue in the United Kingdom, and equivalent state and provincial agencies. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

### **Long-lived Asset Valuation, including Intangible Assets**



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We evaluate long-lived assets, including property and equipment and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the use of the asset. If the estimated undiscounted cash flows change in the future, we may be required to reduce the carrying amount of an asset.

### **Stock-Based Compensation**





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We account for our stock-based awards to employees and non-employees using the fair value method as required by SFAS No. 123(R), *Share-Based Payment*. SFAS No. 123(R) requires that the compensation cost related to share-based payment transactions, measured based on the fair value of the equity or liability instruments issued, be recognized in the financial statements. Determining the fair value of options using the Black-Scholes model, or other currently accepted option valuation models, requires highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated fair value on the grant date. If actual results are not consistent with our assumptions and judgments used in estimating the key assumptions, we may be required to record additional compensation or income tax expense, which could have a material impact on our consolidated financial position and results of operations.

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**Retained Insurance Liabilities**



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We are partially self-insured for certain losses related to medical, general liability, workers' compensation and auto liability. Our liability represents an estimate of the ultimate cost of claims incurred as of the balance sheet date. The estimated liability is not discounted and is established based upon analysis of historical data and actuarial estimates. While we believe these estimates are reasonable based on the information currently available, if actual trends, including the severity of claims and medical cost inflation, differ from our estimates, our financial position, results of operations or cash flows could be impacted.

### **Recently Issued Accounting Standards**



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The information set forth above under Note 10 Recent Accounting Pronouncements contained in the Notes to Consolidated Financial Statements is incorporated herein by reference.

### **Results of Operations**



## Three Months Ended October 31, 2008 Compared to Three Months Ended October 31, 2007

**Revenues.** The following sets forth information on customer revenue by geographic region based on the location of the selling entity (in thousands, except percentages):

	2008	Percentage of Revenue	2007	Percentage of Revenue
North America	\$ 152,155	79%	\$ 140,175	76%
United Kingdom	39,414	21%	43,782	24%
	\$ 191,569	100%	\$ 183,957	100%

Revenues were approximately \$191.6 million during the three months ended October 31, 2008, an increase of approximately \$7.6 million, or 4.1%, over the three months ended October 31, 2007. Revenue growth from same store sales in North America, those opened before November 1, 2007, was approximately \$9.4 million. Revenue growth from new facilities, those opened after November 1, 2007, including facilities in or near Windsor, New Jersey; Walton, Kentucky; Birmingham, Alabama; Minneapolis, Minnesota; Sikeston, Missouri; Prairie Grove, Arkansas; Louisville, Kentucky and Richmond, Virginia was approximately \$2.6 million. Revenue growth in the quarter was adversely affected by the impact of macroeconomic factors on commodity and used car prices, among other factors. Revenues generated in the UK declined by \$4.4 million as the change in currency translation rates reduced revenue by \$5.2 million. We entered the UK market through four acquisitions, the first being the acquisition of Universal Salvage in June 2007. Prior to that transaction, we did not have any operations in the UK.

In the UK, we operate primarily on a principal basis by purchasing cars outright and reselling them for our own account. Under this method, the total amount of the selling price and the total amount of the cost of the car are reflected in the results of operations. In North America, we operate primarily on an agency basis selling the car on behalf of the seller and collecting only a service fee. Under this method only the earned fee is included in the results of operations, not the gross selling price and the cost of the car. In the UK, the percentage of vehicles sold on a principal basis was 69% and 66% for the three months ended October 31, 2008 and 2007, respectively.

**Yard Operation Expenses.** Yard operation expenses were approximately \$112.0 million during the three months ended October 31, 2008, an increase of approximately \$6.4 million, or 6.1%, over the three months ended October 31, 2007. Included in yard expenses is depreciation expense of \$8.3 million which represents an increase of \$0.2 million over the three months ended October 31, 2007. The increase in yard operation expenses was attributable to growth in subhaul costs as the cost of fuel increased and payroll and facilities costs as we increased our world wide network from 135 locations to 145 locations. Also included in yard operations expenses are the cost of purchased cars. The percentage of cars sold that were purchased and the cost of purchased cars sold were 8.1% and \$29.9 million and 8.3% and \$29.2 million for the three months ended October 31, 2008 and 2007, respectively. Consolidated yard operation expenses increased to 54.1% of revenues during the three months ended October 31, 2008, as compared to 52.9% of revenues during the three months ended October 31, 2007.



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**General and Administrative Expenses.** General and administrative expenses were approximately \$20.1 million for the three months ended October 31, 2008, a decrease of approximately \$1.7 million, or 7.7%, from the three months ended October 31, 2007. Included in general and administrative expenses is depreciation and amortization of \$2.5 million, a decrease of \$0.3 million from the three months ended October 31, 2007. Included in general and administrative costs in the first quarter of last year are expenses associated with the modification of certain options of retiring directors and costs relating to employee separations. These costs were non-recurring and totaled \$2.3 million. Included in general and administrative costs for the current quarter is a beneficial legal settlement of \$1.0 million. Excluding the affect of these items, general and administrative costs increased \$1.6 million. The increase was driven primarily by additional development and network resources and the expansion of our IT systems to accommodate anticipated increased traffic and to continue the development of enhancements to VB2 and our seller interfaces. General and administrative expenses decreased slightly to 10.5% of revenues during the three months ended October 31, 2008, as compared to 11.8% during the three months ended October 31, 2007.

**Other Income.** Total other income was approximately \$1.8 million during the three months ended October 31, 2008, a decrease of approximately \$1.7 million over the three months ended October 31, 2007. The decrease was due primarily to a lower cash balance and lower investment yields.

**Income Taxes.** Our effective income tax rates for three months ended October 31, 2008 and 2007 were approximately 39.2% and 37.5%, respectively. The increase was driven primarily by the decrease of favorable tax adjustments such as tax exempt interest income and the increase in certain states income tax liabilities.

**Net Income.** Due to the foregoing factors, we realized net income of approximately \$37.3 million for the three months ended October 31, 2008, compared to net income of approximately \$37.6 million for the three months ended October 31, 2007.

**Liquidity and Capital Resources**

Historically, we have financed our growth through cash generated from operations, public offerings of common stock, the equity issued in conjunction with certain acquisitions and debt financing. Cash and cash equivalents increased by approximately \$11.8 million from July 31, 2008 to October 31, 2008. During the winter months, most of our facilities process 10% to 30% more vehicles than at other times of the year. This increased seasonal volume requires the increased use of our cash to pay out advances and handling costs of the additional business. Our primary source of cash generated by operations is from the collection of sellers fees, buyers fees and reimbursable advances from the proceeds of auctioned salvage vehicles.

As of October 31, 2008, we had working capital of approximately \$106.0 million, including cash and cash equivalents of approximately \$50.8 million. Cash and cash equivalents consisted primarily of funds invested in money market accounts, which bear interest at a variable rate.

We believe that our currently available cash and cash equivalents and cash generated from operations will be sufficient to satisfy our operating and working capital requirements for at least the next 12 months. However, if we experience significant growth in the future, we may be required to raise additional cash through the issuance of new debt or additional equity.

*Operating Activities*



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Net cash provided by operating activities decreased by approximately \$3.3 million to \$52.4 million during the three months ended October 31, 2008 when compared to the three months ended October 31, 2007, due to the timing of routine changes in working capital items.

### *Investing Activities*



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Capital expenditures (excluding those associated with fixed assets attributable to acquisitions) were approximately \$29.2 million and \$19.9 million for the three months ended October 31, 2008 and 2007, respectively. Our capital expenditures are related primarily to opening and improving facilities and acquiring yard equipment. We continue to expand and invest in new and existing facilities and standardize the appearance of existing locations.

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*Financing Activities*

For the three months ended October 31, 2008 and 2007, we generated approximately \$0.7 million and \$13 million, respectively, through the exercise of stock options, including the related excess tax benefit from share-based payment arrangements and shares issued under our Employee Stock Purchase Plan.

In October 2007, our Board of Directors approved a 20 million share increase in our stock repurchase program, bringing the total current authorization to 29 million shares. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. Subject to applicable securities laws, such repurchases will be made at such times and in such amounts as we deem appropriate and may be discontinued at any time. We did not repurchase any shares during the three months ended October 31, 2008 and 2007. The total number of shares repurchased under the program as of October 31, 2008 was approximately 14 million, leaving approximately 15 million available for repurchase by the Company under the repurchase program.

### ***Credit Facility***

On March 6, 2008, we entered into an unsecured credit agreement with Bank of America, N.A. (the Credit Agreement) providing for a \$200 million revolving credit facility (the Credit Facility), including a \$100 million foreign currency borrowing sublimit and a \$50 million letter of credit sublimit. Amounts borrowed under the Credit Facility may be used for repurchases of stock, capital expenditures, working capital and other general corporate purposes. The Credit Facility matures and all outstanding borrowings are due on the fifth anniversary of the Credit Agreement, with annual reductions in availability of \$25 million on each of the first three anniversaries of the Credit Agreement. Amounts borrowed under the Credit Facility may be repaid and re-borrowed until the maturity date and bear interest, at our option, at either Eurocurrency Rate plus 0.5% to 0.875%, depending of the leverage ratio, as defined in the Credit Agreement, at the end of the previous quarter or at the prime rate. A default interest rate applies on all obligations during an event of default under the Credit Facility at a rate per annum equal to 2.0% above the otherwise applicable interest rate. The Credit Facility requires us to pay a commitment fee on the unused portion of the Credit Facility. The commitment fee ranges from 0.075% to 0.15% depending on the leverage ratio as of the end on the previous quarter. The Credit Facility contains customary representations and warranties and places certain business operating restrictions on us relating to, among other things, indebtedness, liens and other encumbrances, investments, mergers and acquisitions, asset sales, and dividends, distributions and redemptions of capital stock. In addition, the Credit Agreement provides for a maximum total leverage ratio and a minimum interest coverage ratio. The Credit Facility contains events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, cross-defaults to certain other indebtedness, bankruptcy and insolvency defaults, material judgments, invalidity of the loan documents and events constituting a change of control. The Credit Facility is guaranteed by our material domestic subsidiaries. As of October 31, 2008, we did not have an outstanding balance under the Credit Facility.

### ***Lease, Purchase and Other Contractual Obligations***





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There were no material changes in the Company's lease, purchase and other contractual obligations during the three months ended October 31, 2008.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our principal exposures to financial market risk are interest rate and foreign currency risk. As of October 31, 2008, our cash and cash equivalents consisted primarily of funds invested in money market accounts, which bear interest at a variable rate. As the interest rates on a material portion of our cash and cash equivalents are variable, a change in interest rates earned on our investment portfolio would impact interest income along with cash flows, but would not materially impact the fair market value of the related underlying instruments.

Our exposure to foreign currency transactions gains and losses arises from the translation of the assets and liabilities of our Canadian and UK subsidiaries to US dollars during consolidation. We do not hedge our exposure to the Canadian dollar or the British pound. We do not use derivative financial instruments for speculative or trading purposes.

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**ITEM 4. CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, or Disclosure Controls, as of the end of the period covered by this Quarterly Report on Form 10-Q. This evaluation, or Controls Evaluation, was performed under the supervision and with the participation of management, including our Chairman of the Board, Chief Executive Officer and Director (our CEO) and our Senior Vice President and Chief Financial Officer (our CFO). Disclosure Controls are controls and procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms. Disclosure Controls include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Our Disclosure Controls include some, but not all, components of our internal control over financial reporting.

Based upon the Controls Evaluation, our CEO and CFO have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q, our Disclosure Controls were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is accumulated and communicated to management, including the CEO and CFO, to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission.

(b) Changes in Internal Controls

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**



**ITEM 1. LEGAL PROCEEDINGS**



The information set forth above under Note 11 Legal Proceedings contained in the Notes to Consolidated Financial Statements is incorporated herein by reference.

#### ITEM 1A. RISK FACTORS

Set forth below and elsewhere in this report and in other documents we file with the SEC are descriptions of the risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this report. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in Part I, Item 1A, Risk Factors of our Annual Report on Form 10-K for the fiscal year ended July 31, 2008.

**We depend on a limited number of major vehicle sellers for a substantial portion of our revenues. The loss of one or more of these major sellers could adversely affect our results of operations and financial condition, and an inability to increase our sources of vehicle supply could adversely affect our growth rates.**

Historically, a limited number of vehicle sellers have accounted for a substantial portion of our revenues. During the first quarter of fiscal 2009, vehicles supplied by our largest seller accounted for approximately 10% of our revenues. Seller arrangements are either written or oral agreements typically subject to cancellation by either party upon 30 to 90 days notice. Vehicle sellers have terminated agreements with us in the past in particular markets, which has affected the pricing for sales services in those markets. There can be no assurance that our existing agreements will not be cancelled. Furthermore, there can be no assurance that we will be able to enter into future agreements with vehicle sellers or that we will be able to retain our existing supply of salvage vehicles. A reduction in our supply of vehicles from a significant vehicle seller or any material changes in the terms of an arrangement with a substantial vehicle seller could have a material adverse effect on our results of operations and financial condition. In addition, a failure to increase our sources of vehicle supply could adversely affect our earnings and revenue growth rates.

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**Our acquisitions in the UK expose us to risks arising from the acquisitions and risks associated with operating in markets outside North America. We may acquire additional companies in the UK or Europe or seek to establish new yards or facilities to complement the acquired companies' operations. We have limited experience operating outside North America, and any failure to integrate these recently acquired companies or future UK or European acquisitions into our operations successfully could have an adverse effect on our financial position, results of operations or cash flows.**

During fiscal 2007, we completed the acquisition of Universal Salvage plc, or Universal, our first acquisition in the UK. In fiscal 2008, we completed the acquisitions of Century Salvage Sales Limited, or Century, Simpson Bros. (York) Holdings, Limited and AG Watson Auto Salvage & Motor Spares (Scotland) Limited all located within the UK. We may continue to acquire additional companies or operations in the UK or Europe or may seek to establish new yards or operations in the UK or Europe now that we have established a presence in these markets. We have limited experience operating our business outside North America, which presents numerous strategic, operational, and financial risks to us.

Our acquisitions in the UK and continued expansion of our operations outside North America pose substantial risks and uncertainties that could have an adverse effect on our future operating results. In particular, we may not be successful in realizing anticipated synergies from these acquisitions, or we may experience unanticipated costs or expenses integrating the acquired operations into our existing business. For example, in the second quarter of fiscal 2008, we experienced losses associated with credit card fraud in the UK. Although historical practice in the UK market has been to accept credit cards, we have not accepted them in North America and may need to further enhance our security systems to reduce the risk of credit card fraud. In addition, our operating expenses were adversely affected in the second quarter by incremental integration expenses. We have and may continue to incur substantial expenses establishing new yards or operations in the UK or Europe. Among other things, we have deployed our VB2 vehicle remarketing technologies at all of our operations in the UK and we cannot predict whether this deployment will be successful or will result in increases in the revenues or operating efficiencies of any acquired companies relative to their historic operating performance. Integration of our respective operations, including information technology integration and integration of financial and administrative functions, may not proceed as we currently anticipate and could result in presently unanticipated costs or expenses (including unanticipated capital expenditures) that could have an adverse effect on our future operating results. We cannot provide any assurances that we will achieve our business and financial objectives in connection with these acquisitions or our strategic decision to expand our operations internationally.

We have limited experience operating our business outside North America and lack familiarity with local laws, regulations and business practices. We will need to develop policies and procedures to manage our business on a global scale. Operationally, the businesses of Universal, Century and AG Watson have depended on key seller relationships, and our failure to maintain those relationships would have an adverse effect on our operating objectives for the UK and could have an adverse effect on our future operating results.

In addition, we anticipate our international operations will subject us to a variety of risks associated with operating on an international basis, including:

- the difficulty of managing and staffing foreign offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;



- the need to localize our product offerings, particularly with respect to VB2;
- tariffs and trade barriers and other regulatory or contractual limitations on our ability to operate in certain foreign markets; and
- exposure to foreign currency exchange rate risk, which we have not been previously subject to in any material amounts and which had an adverse impact on our revenues and revenue growth rates in the first quarter of fiscal 2009.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks successfully could harm our international operations and have an adverse effect on our operating results.

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**If we determine that our goodwill has become impaired, we may incur significant charges to our pre-tax income.**

Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations. In the future, goodwill and intangible assets may increase as a result of future acquisitions. Goodwill and intangible assets are reviewed at least annually for impairment. Impairment may result from, among other things, deterioration in the performance of acquired businesses, adverse market conditions, and adverse changes in applicable laws or regulations, including changes that restrict the activities of the acquired business. Our recent acquisitions of Universal, Century, Simpson Bros. (York) Holdings, Limited and AG Watson Auto Salvage & Motor Spares (Scotland) Limited resulted in a significant increase in the amount of goodwill on our balance sheet. As of October 31, 2008, our total goodwill, subject to future impairment testing, was approximately \$165 million.

**In the UK we operate primarily on a principal basis, purchasing the salvage vehicle outright from the insurance companies and reselling the vehicle to buyers. Continued operations on a principal basis will have a negative impact on our future consolidated gross margin percentages and exposes us to additional inventory risks.**

The period-to-period comparability of our operating results and financial condition is substantially affected by business acquisitions during such periods. In particular, the UK acquisitions, both because of their size and because the UK operates primarily on the principal model versus the agency model employed in North America, will have a significant impact on the comparability of revenues, margins and margin percentages in future periods. Continued operations on a principal basis will have a negative impact on our future consolidated gross margin percentages, and exposes us to inventory risks including:

- loss from theft or damage;
  
- loss from devaluation; and
  
- loss from obsolescence.

**Our strategic shift from live sales to an entirely Internet-based sales model presents new risks, including substantial technology risks.**

During 2004 in North America and during 2008 in the United Kingdom we converted all of our sales from a live auction process to an entirely Internet-based auction-style model based on technology developed internally by us. The conversion represented a significant change in the way we conduct business and currently presents numerous risks, including our increased reliance on the availability and reliability of our network systems. In particular, we believe the conversion presents the following risks, among others:

- Our operating results in a particular period could be adversely affected in the event our networks are not operable for an extended period of time for any reason, as a result of Internet viruses, or as a result of any other technological circumstance that makes us unable to conduct our virtual sales.
- Our business is increasingly reliant on internally developed technology, and we have limited historic experience developing technologies or systems for large-scale implementation and use.
- Our general and administrative expenses have tended to increase as a percentage of revenue as our information technology payroll has increased.
- The change in our business model may make it more difficult for management, investment analysts, and investors to model or predict our future operating results until sufficient historic data is available to evaluate the effect of the VB2 implementation over a longer period of time and in different economic environments.
- Our increasing reliance on proprietary technology subjects us to intellectual property risks, including the risk of third party infringement claims or the risk that we cannot establish or protect intellectual property rights in our technologies. We have filed patent applications for VB2 in the Netherlands, Canada, Australia, China, the European Union, Mexico and Japan, but we cannot provide any assurances that the patents will actually be issued, or if issued that the patents would not later be found to be unenforceable or invalid.

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**Our results of operations may not continue to benefit from the implementation of VB2 to the extent we have experienced in recent periods.**

We believe that the implementation of our proprietary VB2 sales technologies across our operations has had a favorable impact on our results of operations by increasing the size and geographic scope of our buyer base and increasing the average selling price for vehicles sold through our sales. VB2 was implemented across all of our North American and UK salvage yards beginning in fiscal 2004 and fiscal 2008, respectively. We do not believe, however, that we will continue to experience improvements in our results of operations at the same relative rates we have experienced in the last few years. In addition, we cannot predict whether we will experience the same initial benefits from the implementation of VB2 in the UK market, or in future markets we may enter, that we experienced in North America.

**Failure to have sufficient capacity to accept additional cars at one or more of our storage facilities could adversely affect our relationships with insurance companies or other sellers of vehicles.**

Capacity at our storage facilities varies from period to period and from region to region. For example, following adverse weather conditions in a particular area, our yards in that area may fill and limit our ability to accept additional salvage vehicles while we process existing inventories. As discussed below, Hurricanes Katrina and Rita had, in certain quarters, an adverse effect on our operating results, in part because of yard capacity constraints in the Gulf Coast area. We regularly evaluate our capacity in all our markets and, where appropriate, seek to increase capacity through the acquisition of additional land and yards. We may not be able to reach agreements to purchase independent storage facilities in markets where we have limited excess capacity, and zoning restrictions or difficulties obtaining use permits may limit our ability to expand our capacity through acquisitions of new land. Failure to have sufficient capacity at one or more of our yards could adversely affect our relationships with insurance companies or other sellers of vehicles, which could have an adverse effect on our operating results.

**Factors such as mild weather conditions can have an adverse effect on our revenues and operating results as well as our revenue and earnings growth rates by reducing the available supply of salvage vehicles. Conversely, extreme weather conditions can result in an oversupply of salvage vehicles that requires us to incur abnormal expenses to respond to market demands.**

Mild weather conditions tend to result in a decrease in the available supply of salvage vehicles because traffic accidents decrease and fewer automobiles are damaged. Accordingly, mild weather can have an adverse effect on our salvage vehicle inventories, which would be expected to have an adverse effect on our revenue and operating results and related growth rates. Conversely, our inventories will tend to increase in poor weather such as a harsh winter or as a result of adverse weather-related conditions such as flooding. During periods of mild weather conditions, our ability to increase our revenues and improve our operating results and related growth will be increasingly dependent on our ability to obtain additional vehicle sellers and to compete more effectively in the market, each of which is subject to the other risks and uncertainties described in these sections. In addition, extreme weather conditions, although they increase the available supply of salvage cars, can have an adverse effect on our operating results. For example, during the year ended July 31, 2006, we recognized substantial additional costs associated with the impact of Hurricanes Katrina and Rita in Gulf Coast states. These additional costs, characterized as abnormal under Statement of Financial Accounting Standards 151, were recognized during the year ended July 31, 2006, and included the additional subhauling, payroll, equipment and facilities expenses directly related to the operating conditions created by the hurricanes. In the event that we were to again experience extremely adverse weather or other anomalous conditions that result in an abnormally high number of salvage vehicles in one or more of our markets, those conditions could have an adverse effect on our future operating results.

**Macroeconomic factors such as high fuel prices, declines in commodity prices, and declines in used car prices may have an adverse effect on our revenues and operating results as well as our earnings growth rates.**

Macroeconomic factors that affect oil prices and the automobile and commodity markets can have adverse effects on our revenues, revenue growth rates (if any), and operating results. Increases in the cost of fuel could lead to a reduction in miles driven per car and a reduction in accident rates. A material reduction in accident rates could have a material impact on revenue growth. In addition, under our percentage incentive program contracts, or PIP, the cost of towing the vehicle to one of our facilities is included in the PIP fee. We may incur increased fees, which we will not be able to pass on to our sellers of vehicles. A material increase in tow rates could have a material impact on our operating results. Recently, the markets in which we operate have been particularly affected by changes in fuel prices, commodity prices, and decreases in the prices of used cars. In particular, declines in scrap metal and used car prices had an adverse impact on our revenue growth rates in the first quarter of fiscal 2009. Continued volatility in fuel, commodity, and used car prices could have a material adverse effect on our revenues and revenue growth rates in future periods.

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**The salvage vehicle sales industry is highly competitive and we may not be able to compete successfully.**

We face significant competition for the supply of salvage vehicles and for the buyers of those vehicles. We believe our principal competitors include other vehicle remarketing companies with whom we compete directly in obtaining vehicles from insurance companies and other sellers, and large vehicle dismantlers, who may buy salvage vehicles directly from insurance companies, bypassing the salvage sales process. Many of the insurance companies have established relationships with competitive remarketing companies and large dismantlers. Certain of our competitors may have greater financial resources than us. Due to the limited number of vehicle sellers, particularly in the UK, the absence of long-term contractual commitments between us and our sellers and the increasingly competitive market environment, there can be no assurance that our competitors will not gain market share at our expense.

We may also encounter significant competition for local, regional and national supply agreements with vehicle sellers. There can be no assurance that the existence of other local, regional or national contracts entered into by our competitors will not have a material adverse effect on our business or our expansion plans. Furthermore, we are likely to face competition from major competitors in the acquisition of vehicle storage facilities, which could significantly increase the cost of such acquisitions and thereby materially impede our expansion objectives or have a material adverse effect on our results of operations. These potential new competitors may include consolidators of automobile dismantling businesses, organized salvage vehicle buying groups, automobile manufacturers, automobile auctioneers and software companies. While most vehicle sellers have abandoned or reduced efforts to sell salvage vehicles directly without the use of service providers such as us, there can be no assurance that this trend will continue, which could adversely affect our market share, results of operations and financial condition. Additionally, existing or new competitors may be significantly larger and have greater financial and marketing resources than us; therefore, there can be no assurance that we will be able to compete successfully in the future.

**Because the growth of our business has been due in large part to acquisitions and development of new facilities, the rate of growth of our business and revenues may decline if we are not able to successfully complete acquisitions and develop new facilities.**

We seek to increase our sales and profitability through the acquisition of additional facilities and the development of new facilities. There can be no assurance that we will be able to:

- continue to acquire additional facilities on favorable terms;
- expand existing facilities in no-growth regulatory environments;
- increase revenues and profitability at acquired and new facilities;
- maintain the historical revenue and earnings growth rates we have been able to obtain through facility openings and strategic acquisitions; or

- create new vehicle storage facilities that meet our current revenue and profitability requirements.

**As we continue to expand our operations, our failure to manage growth could harm our business and adversely affect our results of operations and financial condition.**

Our ability to manage growth depends not only on our ability to successfully integrate new facilities, but also on our ability to:

- hire, train and manage additional qualified personnel;
- establish new relationships or expand existing relationships with vehicle sellers;
- identify and acquire or lease suitable premises on competitive terms;
- secure adequate capital; and
- maintain the supply of vehicles from vehicle sellers.

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Our inability to control or manage these growth factors effectively could have a material adverse effect on our financial position, results of operations, or cash flows.

**Our annual and quarterly performance may fluctuate, causing the price of our stock to decline.**

Our revenues and operating results have fluctuated in the past and can be expected to continue to fluctuate in the future on a quarterly and annual basis as a result of a number of factors, many of which are beyond our control. Factors that may affect our operating results include, but are not limited to, the following:

- fluctuations in the market value of salvage and used vehicles;
- as a result of our recently acquired companies in the UK, the impact of foreign exchange gain and loss;
- our ability to successfully integrate our newly acquired operations in the UK and any additional international markets we may enter;
- the availability of salvage vehicles;
- variations in vehicle accident rates;
- buyer participation in the Internet bidding process;
- delays or changes in state title processing;
- changes in international, state or federal laws or regulations affecting salvage vehicles;
- changes in local laws affecting who may purchase salvage vehicles;



- our ability to integrate and manage our acquisitions successfully;
- the timing and size of our new facility openings;
- the announcement of new vehicle supply agreements by us or our competitors;
- severity of weather and seasonality of weather patterns;
- the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our business, operations and infrastructure;
- the availability and cost of general business insurance;
- labor costs and collective bargaining;
- availability of subhauliers at competitive rates;
- acceptance of buyers and sellers of our Internet-based model deploying VB2, a proprietary Internet auction-style sales technology;
- changes in the current levels of out of state and foreign demand for salvage vehicles;
- the introduction of a similar Internet product by a competitor; and
- the ability to obtain necessary permits to operate.

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Due to the foregoing factors, our operating results in one or more future periods can be expected to fluctuate. As a result, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as any indication of future performance. In the event such fluctuations result in our financial performance being below the expectations of public market analysts and investors, the price of our common stock could decline substantially.

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**Our strategic shift to an Internet-based sales model has increased the relative importance of intellectual property assets to our business, and any inability to protect those rights could have a material adverse effect on our business, financial condition, or results of operations.**

Implementation of VB2 in our operations has increased the relative importance of intellectual property rights to our business. Our intellectual property rights include a patent for VB2 as well as trademarks, trade secrets, copyrights and other intellectual property rights. In addition, we may enter into agreements with third parties regarding the license or other use of our intellectual property in foreign jurisdictions. Effective intellectual property protection may not be available in every country in which our products and services are distributed, deployed, or made available. We seek to maintain certain intellectual property rights as trade secrets. The secrecy could be compromised by third parties, or intentionally or accidentally by our employees, which would cause us to lose the competitive advantage resulting from those trade secrets. Any significant impairment of our intellectual property rights, or any inability to protect our intellectual property rights, could have a material adverse effect on our financial position, results of operations, or cash flows.

**We have in the past been and may in the future be subject to intellectual property rights claims, which are costly to defend, could require us to pay damages, and could limit our ability to use certain technologies in the future.**

Litigation based on allegations of infringement or other violations of intellectual property rights are common among companies who rely heavily on intellectual property rights. Our reliance on intellectual property rights has increased significantly in recent years as we have implemented our VB2 auction-style sales technologies across our business and ceased conducting live auctions in our North American operations. As we face increasing competition, the possibility of intellectual property rights claims against us grows. Litigation and any other intellectual property claims, whether with or without merit, can be time-consuming, expensive to litigate and settle, and can divert management resources and attention from our core business. An adverse determination in current or future litigation could prevent us from offering our products and services in the manner currently conducted. We may also have to pay damages or seek a license for the technology, which may not be available on reasonable terms and which may significantly increase our operating expenses, if it is available for us to license at all. We could also be required to develop alternative non-infringing technology, which could require significant effort and expense.

**Government regulation of the salvage vehicle sales industry may impair our operations, increase our costs of doing business and create potential liability.**

Participants in the salvage vehicle sales industry are subject to, and may be required to expend funds to ensure compliance with, a variety of governmental, regulatory and administrative rules, regulations, land use ordinances, licensure requirements and procedures, including those governing vehicle registration, the environment, zoning and land use. Failure to comply with present or future regulations or changes in interpretations of existing regulations may result in impairment of our operations and the imposition of penalties and other liabilities. At various times, we may be involved in disputes with local governmental officials regarding the development and/or operation of our business facilities. We believe that we are in compliance in all material respects with applicable regulatory requirements. We may be subject to similar types of regulations by federal, national, international, provincial, state, and local governmental agencies in new markets. In addition, new regulatory

requirements or changes in existing requirements may delay or increase the cost of opening new facilities, may limit our base of salvage vehicle buyers and may decrease demand for our vehicles.

**Changes in laws affecting the importation of salvage vehicles may have an adverse effect on our business and financial condition.**

Our Internet-based auction-style model has allowed us to offer our products and services to international markets and has increased our international buyer base. As a result, foreign importers of salvage vehicles now represent a significant part of our total buyer base. Changes in laws and regulations that restrict the importation of salvage vehicles into foreign countries may reduce the demand for salvage vehicles and impact our ability to maintain or increase our international buyer base. For example, in March 2008, a decree issued by the president of Mexico became effective that placed restrictions on the types of vehicles that can be imported into Mexico from the United States. The adoption of similar laws or regulations in other jurisdictions that have the effect of reducing or curtailing our activities abroad could have a material adverse effect on our results of operations and financial condition by reducing the demand for our products and services.

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**The operation of our storage facilities poses certain environmental risks, which could adversely effect our financial position, results of operations or cash flows.**

Our operations are subject to federal, state, national, provincial and local laws and regulations regarding the protection of the environment in the countries which we have storage facilities. In the salvage vehicle remarketing industry, large numbers of wrecked vehicles are stored at storage facilities and, during that time, spills of fuel, motor oil and other fluids may occur, resulting in soil, surface water or groundwater contamination. In addition, certain of our facilities generate and/or store petroleum products and other hazardous materials, including waste solvents and used oil. In the UK, we provide vehicle de-pollution and crushing services for End-of-Life program vehicles. We could incur substantial expenditures for preventative, investigative or remedial action and could be exposed to liability arising from our operations, contamination by previous users of certain of our acquired facilities, or the disposal of our waste at off-site locations. Environmental laws and regulations could become more stringent over time and there can be no assurance that we or our operations will not be subject to significant costs in the future. Although we have obtained indemnification for pre-existing environmental liabilities from many of the persons and entities from whom we have acquired facilities, there can be no assurance that such indemnifications will be adequate. Any such expenditures or liabilities could have a material adverse effect on our results of operations and financial condition.

**If we experience problems with our trucking fleet operations, our business could be harmed.**

We rely solely upon independent subhauers to pick up and deliver vehicles to and from our North American storage facilities. We also utilize, to a lesser extent, independent subhauers in the UK. Our failure to pick up and deliver vehicles in a timely and accurate manner could harm our reputation and brand, which could have a material adverse effect on our business. Further, an increase in fuel cost may lead to increased prices charged by our independent subhauers, which may significantly increase our cost. We may not be able to pass these costs on to our sellers or buyers.

In addition to using independent subhauers in the UK, we utilize a fleet of company trucks to pick up and deliver vehicles from our UK storage facilities. In connection therewith, we are subject to the risks associated with providing trucking services, including inclement weather, disruptions in transportation infrastructure, availability and price of fuel, any of which could result in an increase in our operating expenses and reduction in our net income.

**We are partially self-insured for certain losses and if our estimates of the cost of future claims differ from actual trends, our results of our operations could be harmed.**

We are partially self-insured for certain losses related to medical insurance, general liability, workers compensation and auto liability. Our liability represents an estimate of the ultimate cost of claims incurred as of the balance sheet date. The estimated liability is not discounted and is established based upon analysis of historical data and actuarial estimates. While we believe these estimates are reasonable based on the information currently available, if actual trends, including the severity of claims and medical cost inflation, differ from our estimates, our results of operations could be impacted. Further, we rely on independent actuaries to assist us in establishing the proper amount of reserves for anticipated payouts associated with these self-insured exposures.

**Our executive officers, directors and their affiliates hold a large percentage of our stock and their interests may differ from other shareholders.**

Our executive officers, directors and their affiliates beneficially own, in the aggregate, approximately 24% of our common stock as of October 31, 2008. If they were to act together, these shareholders would have significant influence over most matters requiring approval by shareholders, including the election of directors, any amendments to our articles of incorporation and certain significant corporate transactions, including potential merger or acquisition transactions. In addition, without the consent of these shareholders, we could be delayed or prevented from entering into transactions that could be beneficial to us or our other investors. These shareholders may take these actions even if they are opposed by our other investors.

**We have a shareholder rights plan, or poison pill, which could affect the price of our common stock and make it more difficult for a potential acquirer to purchase a large portion of our securities, to initiate a tender offer or a proxy contest, or to acquire us.**

In March 2003, our board of directors adopted a shareholder rights plan, commonly known as a poison pill. The poison pill may discourage, delay, or prevent a third party from acquiring a large portion of our securities, initiating a tender offer or proxy contest, or acquiring us through an acquisition, merger, or similar transaction. Such an acquirer could be prevented from consummating one of these transactions even if our shareholders might receive a premium for their shares over then-current market prices.

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**If we lose key management or are unable to attract and retain the talent required for our business, we may not be able to successfully manage our business or achieve our objectives.**

Our future success depends in large part upon the leadership and performance of our executive management team, all of whom are employed on an at-will basis and none of whom are subject to any agreements not to compete. If we lose the service of one or more of our executive officers or key employees, in particular Willis J. Johnson, our Chief Executive Officer, and A. Jayson Adair, our President, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, we may not be able to successfully manage our business or achieve our business objectives.

**Our cash investments are subject to numerous risks.**

We may invest our excess cash in securities or money market funds backed by securities, which may include US treasuries, other federal, state and municipal debt, bonds, preferred stock, commercial paper, insurance contracts and other securities both privately and publicly traded. All securities are subject to risk, including fluctuations in interest rates, credit risk, market risk and systemic economic risk. Changes or movements in any of these risks may result in a loss or an impairment to our invested cash and may have a material affect on our financial statements.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

In October 2007, the Company's Board of Directors approved a 20 million share increase in the Company's stock repurchase program, bringing the total current number of shares authorized for repurchase to 29 million shares. The Company's stock repurchase program is more fully described above under Note 6 in the Note to Consolidated Financial Statements, and the disclosures made in Note 6 are incorporated herein by reference. The Company did not repurchase any shares during the three months ended October 31, 2008.

**ITEM 6. EXHIBITS**

(a) Exhibits

- 10.1\* Amended and Restated Executive Officer Employment Agreement between the Company and William E. Franklin, dated September 25, 2008
- 31.1 Certification of Willis J. Johnson, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of William E. Franklin, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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- 32.1 Certification of Willis J. Johnson, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of William E. Franklin, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\*Management contract, plan or arrangement



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**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.

COPART, INC.

/s/ William E. Franklin  
William E. Franklin, Senior Vice President and Chief  
Financial Officer (duly authorized officer and principal  
financial and accounting officer)

Date: December 10, 2008