

COPART INC  
Form 10-K  
October 31, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

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**Form 10-K**

**ANNUAL REPORTS PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended: **July 31, 2006**
- 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)

**California**  
*(State or other jurisdiction of  
incorporation or organization)*  
**4665 Business Center Drive**  
**Fairfield, California**  
*(Address of principal executive offices)*

**94-2867490**  
*(I.R.S. Employer  
Identification Number)*  
**94534**  
*(Zip code)*

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

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of each exchange on which registered
Common Stock	The NASDAQ Stock Market LLC

**Securities registered pursuant to Section 12(g) of the Act: None**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

## Edgar Filing: COPART INC - Form 10-K

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in the Exchange Act Rule 12b-2).

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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

The aggregate market value of the voting and non-voting Common Stock held by non-affiliates of the registrant as of January 31, 2006 (the last business day of the registrant's most recently completed second fiscal quarter) was \$1,361,457,000 based upon the last sales price reported for such date on the NASDAQ Global Select Market (formerly the NASDAQ National Market). For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive for other purposes.

At October 30, 2006, registrant had 90,553,228 outstanding shares of Common Stock.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Items 10, 11, 12, 13, and 14 of Part III incorporate certain information by reference from the registrant's definitive proxy statement for the Annual Meeting of Shareholders ( Proxy Statement ). Except with respect to the information specifically incorporated by reference, the Proxy Statement is not deemed to be filed as a part hereof.

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*This report, including the information incorporated by reference herein, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. 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, cont these terms or other comparable terminology. The forward-looking statements contained in this report 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 factors include those listed in Item 1A Business under the caption entitled Risk Factors beginning on page 15 of this report and those discussed elsewhere in this report. We encourage investors to review these factors carefully.*

*Although we believe that, based on information currently available to Copart 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.*

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**PART I**

**Item 1. Business**

**General**

Copart, Inc. is a leading provider of salvage vehicle sales services in the United States.

We provide vehicle suppliers, primarily insurance companies, with a full range of services to process and sell salvage vehicles over the Internet through our Virtual Bidding Second Generation ( VB2 ) Internet auction-style sales technology. We sell principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters. Salvage vehicles are either damaged vehicles deemed a total loss for insurance or business purposes or are recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. We offer vehicle suppliers a full range of services that expedite each stage of the salvage vehicle sales process and minimize administrative and processing costs. We generate revenues primarily from fees paid by vehicle suppliers and vehicle buyers as well as related fees for services such as towing and storage.

We have grown our salvage vehicle sales business through a combination of acquisitions and the development of new facilities and also by increasing our buyer base and implementing additional value-added services for both buyers and suppliers. For fiscal year 2006, our revenues were approximately \$528.6 million and our operating income was approximately \$171.6 million from continuing operations. During the fiscal year ending July 31, 2006, we acquired seven salvage vehicle storage facilities and opened four new salvage vehicle storage facilities. We acquired storage sites located in Greenwood, Nebraska; Grand Island, Nebraska; York Haven, Pennsylvania; Chambersburg, Pennsylvania; Altoona, Pennsylvania; Fruitland, Maryland and Billings, Montana. We opened new vehicle storage sites in Honolulu, Hawaii; Lansing, Michigan; Dover, Florida and Jacksonville, Florida.

During fiscal 2004, we converted all of our salvage vehicle storage facilities to an Internet based auction-style model using VB2. This second generation technology combines two bidding processes. An open Preliminary Bidding feature allows a buyer to enter bids either at a bidding station at the storage facility during the three preview days or over the Internet. To improve the effectiveness of bidding, the VB2 system lets a buyer see the current high bid on the vehicle they want to purchase. The preliminary bidding phase is an open sales format. Buyers enter the maximum price they are willing to pay for a vehicle and VB2's BID4U feature will incrementally bid the vehicle on their behalf. Preliminary bidding ends one hour prior to the start of an Internet-only virtual sale. BID4U will represent the high preliminary bidder at the Internet-only virtual sale. This feature allows bidders the opportunity to bid against each other and the high preliminary bidder. The bidders enter bids via the Internet in a real time format. BID4U submits bids for the high preliminary bidder, up to their maximum bid. When bidding stops, a countdown is initiated. If no bids are received during the countdown, the vehicle sells to the highest bidder. VB2 opens our sales process to registered buyers anywhere in the world who have Internet access.

We believe the implementation of VB2 across our salvage operations has increased the pool of available buyers for each sale and the added competition has increased the amount buyers are willing to pay for vehicles from us. We also believe that it has improved the efficiency of our operations. For fiscal 2006, sales of vehicles to buyers outside the state where the vehicle is located accounted for 50% of total vehicles sold (26% of salvage vehicles were sold to out of state buyers and 24% were sold to buyers out of country, based on registration).

We believe that we offer the highest level of service in the salvage vehicle sales and auction industry and have established our leading market position by:

- providing coverage that facilitates supplier access to buyers around the world, reducing towing and third-party storage expenses, offering a local presence for vehicle inspection stations, and providing prompt response to catastrophes and natural disasters by specially-trained teams;
- providing a comprehensive range of customer services that include merchandising services, efficient title processing, timely pick-up and delivery of vehicles and Internet sales;
- establishing and efficiently integrating new facilities and acquisitions;
- increasing the number of bidders that can participate at each sale through the ease and convenience of Internet bidding;
- applying technology to enhance operating efficiency through Internet bidding, web-based order processing, salvage value quotes, electronic communication with buyers and sellers, vehicle imaging and an electronic used vehicle parts locator service; and
- providing the venue for insurance customers through our Virtual Insured Exchange VIX product to enter a vehicle into a live virtual sale to establish its true value, thereby allowing the insurance customer to avoid dealing with estimated values when negotiating with owners who wish to retain their damaged vehicles.

We adopted a formal plan in fiscal 2006 to discontinue the operations of our public auction business Motors Auction Group ( MAG ), a wholly owned subsidiary, and dispose of the related assets or convert them to our salvage business. We operated six public automobile sales facilities located in Detroit, Michigan; Chesapeake, Virginia; New Castle, Delaware; Greencastle, Pennsylvania; Pittsburgh, Pennsylvania and Richmond, Virginia. We sold the businesses located in Chesapeake, New Castle and Greencastle prior to the end of fiscal 2006. We converted Detroit, Pittsburgh and Richmond into salvage facilities. As of the end of fiscal 2006 no MAG operations remain.

We were organized as a California corporation in 1982 and became a public company in 1994. Our principal executive offices are located at 4665 Business Center Drive, Fairfield, California 94534, and our telephone number at that address is (707) 639-5000. We maintain a website, <http://www.copart.com>, where we make available, free of charge, our code of ethics and our Securities and Exchange Commission filings, including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. We are providing the address to our website solely for the information of investors. Information contained on our website is not incorporated by reference herein and our web address is included as an inactive textual reference only.

#### **Industry Overview**

The salvage vehicle industry provides a venue for salvage vehicle suppliers to liquidate total loss vehicles. Salvage vehicle sales companies generally auction or sell salvage vehicles on consignment either for a fixed fee or a percentage of the sales price. On occasion, salvage sales companies may purchase vehicles from vehicle suppliers at a formula-based price, based on a percentage of the vehicles estimated pre-loss value ( actual cash value ) and sell the vehicles for their own account. Salvage vehicle sales companies typically operate from one or more salvage facilities where vehicles are processed, viewed, stored and sold. However, Copart through the introduction of VB2, eliminated local live auctions in our operations, and we now sell all our salvage vehicles over the Internet.

Although there are other suppliers of salvage vehicles, such as financial institutions, vehicle leasing companies, automobile rental companies, charities and automobile dealers, the primary source of salvage vehicles is insurance companies.

Automobile manufacturers are incorporating certain standard features that increase passenger safety, including unibody construction, passenger safety cages with surrounding crumple zones to absorb impacts, plastic components, airbags, xenon lights and computer systems. We believe that one effect of these features is that newer vehicles involved in accidents are more likely to be deemed a total loss for insurance purposes, which could result in an increasing supply of total loss salvage vehicles in the future.

The primary buyers of salvage vehicles are vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters. Vehicle dismantlers, which we believe are the largest group of salvage vehicle buyers, either dismantle a vehicle and sell parts individually or sell the entire vehicle to rebuilders, used vehicle dealers or the public. Vehicle rebuilders and vehicle repair licensees generally purchase salvage vehicles to repair and resell. Used vehicle dealers generally purchase recovered stolen or slightly damaged vehicles for resale.

Following an accident involving an insured vehicle, the damaged vehicle is generally towed to a towing company or a vehicle repair facility for temporary storage pending insurance company examination. The vehicle is inspected by the insurance company's adjuster, who estimates the costs of repairing the vehicle and gathers information regarding the damaged vehicle's mileage, options and condition in order to estimate its actual cash value (fair market value). The adjuster determines whether to pay for repairs or to classify the vehicle as a total loss based upon the adjuster's estimate of repair costs and the vehicle's salvage value, as well as customer service considerations. If the cost of repair is greater than the actual cash value less the estimated salvage value, the insurance company generally will classify the vehicle as a total loss. The insurance company will thereafter assign the vehicle to a salvage vehicle sales company, settle with the insured vehicle owner and receive title to the vehicle.

The primary factors that vehicle suppliers consider when selecting a salvage vehicle sales company include:

- the anticipated percentage return on salvage (i.e., gross salvage proceeds, minus vehicle handling and selling expenses, divided by the actual cash value);
- the services provided by the salvage vehicle sales company and the degree to which such services reduce administrative costs and expenses;
- the price the salvage vehicle sales company charges for its services;
- national coverage and ability to respond on a national scale; and
- the ability to generate custom seller reports.

Upon receipt of the pick up order (the assignment), the salvage vehicle sales company arranges for the transport of a vehicle to a facility. As a service to the vehicle supplier, the salvage vehicle sales company will customarily pay advance charges (reimbursable charges paid on behalf of vehicle suppliers) to obtain the subject vehicle's release from a towing company or vehicle repair facility. Typically, advance charges paid on behalf of the vehicle supplier are recovered upon sale of the salvage vehicle.

The vehicle then remains in storage until ownership documents are transferred from the insured vehicle owner and the title to the vehicle is cleared through the appropriate state's motor vehicle regulatory agency ( DMV ). Total loss vehicles may be sold

in most states only after obtaining a salvage title from the DMV. Upon receipt of the appropriate documentation from the DMV, which is generally received within 45 to 60 days of vehicle pick-up, the vehicle is sold.

### Operating and Growth Strategy

Our growth strategy is to increase our revenues and profitability by, among other things (i) acquiring and developing new salvage vehicle storage facilities in key markets, (ii) pursuing national and regional vehicle supply agreements, (iii) expanding our service offerings to suppliers 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 affect cost efficiencies at each of our acquired facilities by introducing our operational procedures, integrating our management information systems and redeploying personnel when necessary.

As part of our overall expansion strategy, our objective is to increase our revenues, operating profits and market share in the vehicle sales industry. To implement our growth strategy, we intend to continue to do the following:

#### *Acquire and Develop New Salvage Vehicle Storage Facilities in Key Markets*

Our strategy is to offer integrated services to vehicle suppliers on a national or regional basis by acquiring or developing salvage facilities in new and existing markets. We integrate our new acquisitions into our national network and capitalize on certain operating efficiencies resulting from, among other things, the reduction of duplicative overhead and the implementation of our operating procedures.

The following table sets forth facilities that we have acquired or opened from August 1, 2003 through July 31, 2006.

Salvage Locations	Acquisition/ Opening Date	Geographic Service Area
Toronto, Canada	September 2003	Ontario, Canada
Eugene, Oregon	September 2003	Central Oregon
Helena, Montana	January 2004	Montana
Cleveland, Ohio	June 2004	Northeast Ohio and Northwestern Pennsylvania
Anchorage, Alaska	July 2004	Alaska
Strongsville, Ohio	January 2005	Northwest Ohio
Ocala, Florida	February 2005	Central Florida
Knoxville, Tennessee	February 2005	Eastern Tennessee
Lexington, Kentucky	April 2005	Northern and Central Kentucky
Loganville, Georgia	April 2005	Central Georgia
Spokane, Washington	July 2005	Eastern Washington and Northern Idaho
Tallahassee, Florida	July 2005	Gulf Region
Hialeah, Florida	July 2005	Southeast Florida
Columbia, Missouri	July 2005	Central Missouri
Honolulu, Hawaii	August 2005	Hawaii
Greenwood, Nebraska	September 2005	Eastern Nebraska
Grand Island, Nebraska	September 2005	Eastern Nebraska
York Haven, Pennsylvania	November 2005	Southern Pennsylvania
Chambersburg, Pennsylvania	November 2005	Southern Pennsylvania
Altoona, Pennsylvania	November 2005	Central Pennsylvania
Fruitland, Maryland	November 2005	Eastern Maryland
Lansing, Michigan	December 2005	Central Michigan
Billings, Montana	March 2006	Central Montana
Dover, Florida	July 2006	Western Florida
Jacksonville, Florida	July 2006	Northeast Florida



***Pursue National and Regional Vehicle Supply Agreements***

Our broad national presence enhances our ability to enter into local, regional or national supply agreements with vehicle suppliers. We actively seek to establish national and regional supply agreements with insurance companies by promoting our ability to achieve high net returns and broader access to buyers through our national coverage and electronic commerce capabilities. By utilizing our existing insurance company supplier relationships, we are able to build new supplier relationships and pursue additional supply agreements in existing and new markets.

***Expand Our Service Offerings to Suppliers and Buyers***

Over the past several years, we have expanded our available service offerings to vehicle suppliers and buyers. The primary focus of these new service offerings is to maximize returns to our suppliers and maximize product value to our buyers. Recent service enhancements include, for our suppliers, real-time access to sales data over the Internet and, for our buyers, the implementation of VB2 real-time bidding at all of our facilities, permitting buyers at any location worldwide to participate in the sales at all of our yards in North America. We plan to continue to refine and expand our services, including offering software that can assist our suppliers in expediting claims and salvage management tools that help suppliers integrate their systems with ours.

***Our Competitive Advantages***

We believe that the following attributes and the services that we offer position us to take advantage of many opportunities in the salvage vehicle sales industry.

***National Coverage and Ability to Respond on a National Scale***

Since our inception in 1982, we have expanded from a single facility in Vallejo, California to an integrated network of 122 facilities located in the United States and Canada as of July 31, 2006. We are able to offer integrated services on a national basis to our vehicle suppliers, which allow us to respond to the needs of our suppliers and buyers with maximum efficiency. Our national coverage provides our suppliers with key advantages, including:

- a reduction in administrative time and effort;
- a reduction in overall vehicle towing costs;
- convenient local facilities;
- improved access to buyers throughout the world;
- a prompt response in the event of a natural disaster or other catastrophe; and
- consistency in salvage vehicle processing.

***Value-Added Services***

We believe that we offer the most comprehensive range of services in our industry, including:

- Internet bidding, Internet proxy bidding and virtual sales powered by VB2, which enhance the competitive bidding process;
- online payment capabilities via our ePay product;



- e-mail notifications to potential buyers of salvage vehicles that match desired characteristics;
- sophisticated vehicle processing at storage sites, including ten-view digital imaging of each vehicle and the scanning of each vehicle's title and other significant documents such as body shop invoices, all of which are available from us through the Internet;
- CoPartfinder, our Internet-based used vehicle parts locator that provides vehicle dismantlers with greater resale opportunities for their salvage purchases;
- Offsite sales, which allow vehicle suppliers to sell any vehicle, boat, or heavy equipment without transporting it to one of our facilities;
- Specialty sales, which allow buyers the opportunity to focus on select types of vehicles regardless of location, as we conduct a single national auction by vehicle type: i.e. motorcycles, heavy equipment, boats, recreational vehicles and rental cars; and
- Interactive Online Counter Bidding, which allows sellers who have placed a minimum bid or a bid to be approved on a vehicle to directly counter bid the current high bidder.

***Proven Ability to Acquire and Integrate Acquisitions***

We have a proven track record of successfully acquiring and integrating salvage vehicle storage facilities. Since becoming a public company in 1994, we have completed the acquisition of 67 salvage vehicle storage facilities. As part of our acquisition and integration strategy, we seek to:

- strengthen our national network and access new markets;
- utilize our existing corporate and technology infrastructure over a larger base of operations; and
- introduce our comprehensive services and operational expertise.

We strive to integrate all new facilities into our existing network without disruption of service to vehicle suppliers. We work with new suppliers to implement our fee structures and new service programs. We typically retain existing employees at acquired facilities in order to retain knowledge about, and respond to, the local market. We also assign a special integration team to help convert newly acquired facilities to our own management information and proprietary software systems, enabling us to ensure a smooth and consistent transition to our business operating and sales systems.

***Technology to Enhance and Expand Our Business***

We have developed management information and proprietary software systems that allow us to deliver a fully integrated service offering. Our proprietary software programs provide vehicle suppliers with online access to data and reports regarding their salvage vehicles being processed at any of our facilities. This technology allows vehicle suppliers to monitor each stage of our salvage vehicle sales process, from pick up to sale and settlement by the buyer. Our full range of Internet services allows us to expedite each stage of the salvage vehicle sales process and minimizes the administrative and processing costs for us as well as our suppliers. We believe that our integrated technology systems generate improved capacity and financial returns for our clients, resulting in high client retention, and allow us to expand our national supply contracts.

### **Our Service Offerings**

We offer vehicle suppliers a full range of services, which expedite each stage of the salvage vehicle sales process, maximizing proceeds and minimizing costs.

#### ***Online Supplier Access***

Through Copart Access, our Internet-based service for vehicle suppliers, we enable suppliers to assign vehicles for sale, check sales calendars, view vehicle images and history, view and reprint body shop invoices and towing receipts and view the historical performance of the vehicles sold at our sales.

#### ***Salvage Estimation Services***

We offer Copart ProQuote, a proprietary service that assists suppliers in the vehicle claims evaluation process by providing online salvage value estimates, which helps suppliers determine whether to repair a particular vehicle or deem it a total loss.

#### ***Virtual Insured Exchange ( VIX )***

We provide the venue for insurance customers to enter a vehicle into a live virtual auction-style sale to establish its true value, thereby allowing the insurance customer to avoid dealing with estimated values when negotiating with owners who wish to retain their damaged vehicles.

#### ***Transportation Services***

We maintain contracts with third-party vehicle transport companies, which enables us to pick up most of our suppliers' vehicles within 24 hours. Our national network and transportation capabilities provides cost and time savings to our vehicle suppliers and ensures on-time vehicle pick up and prompt response to catastrophes and natural disasters.

#### ***Vehicle Inspection Stations***

We offer certain of our major insurance company suppliers office and yard space to house vehicle inspection stations on-site at our storage facilities. We have over 30 vehicle inspection stations at our facilities nationwide. An on-site vehicle inspection station provides our insurance company suppliers with a central location to inspect potential total loss vehicles, which reduces storage charges that otherwise may be incurred at the initial storage or repair facility.

#### ***On-Demand Reporting***

We provide vehicle suppliers with on-demand reports online, via fax or e-mail that summarize data on salvage vehicles that we process for the particular supplier. These reports track our vehicle suppliers' gross and net returns on each vehicle, service charges, and other data that enable our vehicle suppliers to more easily administer and monitor the salvage vehicle disposition process.

#### ***DMV Processing***

We have extensive expertise in DMV document and title processing for salvage vehicles. We have developed a computer system which provides a direct link to the DMV computer systems of several states. This allows us to expedite the processing of vehicle title paperwork.

### ***Flexible Vehicle Processing Programs***

At the election of the vehicle supplier, we sell vehicles pursuant to our Percentage Incentive Program consignment basis or on a fixed fee consignment basis.

***Percentage Fee Consignment.*** Our Percentage Incentive Program ( PIP ) is an innovative processing program designed to broadly serve the needs of vehicle suppliers. Under PIP, we agree to sell all of the salvage vehicles of a vehicle supplier in a specified market, usually for a predetermined percentage of the vehicle sales price. Because our revenues under PIP are directly linked to the vehicle's sale price, we have an incentive to actively merchandise those vehicles to maximize the net return on salvage vehicles. We provide the vehicle supplier, at our expense, with transport of the vehicle to our nearest facility, storage for up to 90 days and DMV document and title processing. In addition, we provide merchandising services such as covering or taping openings to protect vehicle interiors from weather, washing vehicle exteriors, vacuuming vehicle interiors, cleaning and polishing dashboards and tires, making keys for drivable vehicles and identifying drivable vehicles. We believe our merchandising efforts increase the sales prices of salvage vehicles, thereby increasing the return on salvage vehicles to both vehicle suppliers and us.

***Fixed Fee Consignment.*** Under our fixed fee consignment program, we sell vehicles for a fixed consignment fee, generally \$50 to \$175 per vehicle. 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.

### ***Buyer Network***

We maintain a database of thousands of registered buyers of salvage vehicles in the vehicle dismantling, rebuilding, repair, resale and exporting businesses. Our database includes each buyer's vehicle preference and purchasing history. This data enables us to notify via e-mail prospective buyers throughout the world of salvage vehicles available for bidding that match their vehicle preferences. Listings of salvage vehicles to be sold on a particular day and location are also made available on the Internet.

### ***Sales Process***

We offer a flexible and unique sales process designed to maximize the sale prices of the vehicles. We utilize VB2, an auction-style sales methodology that we developed. This second generation technology combines two bidding processes. An open Preliminary Bidding feature allows a buyer to enter bids either at a bidding station at the storage facility during the three preview days or over the Internet. To improve the effectiveness of bidding, the VB2 system lets a buyer see the current high bid on the vehicle they want to purchase. The preliminary bidding phase is an open sales format. Buyers enter the maximum price they are willing to pay for a vehicle and BID4U will incrementally bid the vehicle on their behalf. Preliminary bidding ends one hour prior to the start of an Internet-only virtual sale. BID4U will represent the high preliminary bidder at the Internet-only virtual sale. This feature allows bidders the opportunity to bid against each other and the high preliminary bidder. The bidders enter bids via the Internet in a real time format. BID4U submits bids for the high preliminary bidder, up to their maximum bid. When bidding stops, a countdown is initiated. If no bids are received during the countdown, the vehicle sells to the highest bidder. VB2 opens our sales process to registered buyers anywhere in the world who have Internet access.

### ***CoPartfinder***

CoPartfinder is our unique Internet search engine that enables users to locate used vehicle parts quickly and efficiently. CoPartfinder is accessible by the public through a Copart-sponsored website. CoPartfinder lists vehicles recently sold through VB2

and identifies certain purchasers. This allows vehicle dismantlers and other resellers to streamline their parts sale process and access a large pool of potential buyers. Parts buyers can use CoPartfinder to search for specific vehicle makes and models and view digital images of vehicles that meet their requirements. Once a specific parts supplier is identified for a specific part requirement, buyers may have the option to call, fax, or e-mail the dismantler/supplier. We believe that CoPartfinder provides an incentive for vehicle dismantlers to purchase their salvage vehicles through our sales process.

### **Supply Arrangements and Supplier Marketing**

We obtain salvage vehicles from hundreds of different vehicle suppliers. State Farm Insurance Company accounted for 14%, 12% and 12% of our revenues for fiscal years 2006, 2005 and 2004, respectively. Of the total number of vehicles that we processed in fiscal years 2006, 2005 and 2004, we obtained approximately 83%, 79% and 85%, respectively, from insurance company suppliers. Our arrangements with our suppliers are typically subject to cancellation by either party upon 30 to 90 days notice.

We typically contract with the regional or branch office of an insurance company or other vehicle suppliers. The agreements are customized to each vehicle supplier's particular needs and often provide for the disposition of different types of salvage vehicles by differing methods. Our arrangements generally provide that we will sell total loss and recovered stolen vehicles generated by the vehicle supplier in a designated geographic area.

We market our services to vehicle suppliers through an in-house sales force that utilizes a variety of sales techniques, including targeted mailing of our sales literature, telemarketing, follow-up personal sales calls, and participation in trade shows and vehicle and insurance industry conventions. Based upon our historical data on salvage vehicles and vehicle information supplied by vehicle suppliers, our marketing personnel will provide vehicle suppliers with detailed analysis of the net return on salvage vehicles and a proposal setting forth ways in which we believe that we can improve net returns on salvage vehicles and reduce administrative costs and expenses.

### **Buyers**

We maintain a database of thousands of registered buyers of salvage vehicles in the vehicle dismantling, rebuilding, repair, resale and export businesses. We believe that we have established a broad international and domestic buyer base by providing buyers of salvage vehicles with a variety of programs and services. To gain admission to one of our sales and become a registered buyer, prospective buyers must first pay an initial registration fee and an annual fee, provide requested personal and business information and have, in most states, a vehicle dismantler's, dealer's, resale, repair or export license. Registration entitles a buyer to transact business at any of our sales subject to local licensing and permitting requirements. A buyer may also bring guests to a facility for a fee to preview vehicles for sale. Strict admission procedures are intended to prevent frivolous bids that would invalidate the sale. We market to buyers on the Internet and via e-mail notifications, sales notices, telemarketing and participation in trade show events.

### **Competition**

We face significant competition for the supply of salvage vehicles and for the buyers of those vehicles. We believe our principal competitors include vehicle auction and sales companies and vehicle dismantlers. These national, regional and local competitors may have established relationships with vehicle suppliers and buyers and may have financial resources that are greater than ours. The largest national or regional vehicle auctioneers include the ADESA Corporation; Auction Broadcasting Company; Insurance Auto Auctions, Inc.; Manheim Auctions and SADISCO. The largest national dismantlers include Greenleaf and

LKQ Corporation. These national dismantlers, in addition to trade groups of dismantlers such as the American Recycling Association and the United Recyclers Group, may purchase salvage vehicles directly from insurance companies, thereby bypassing auction and sales companies entirely, including us.

### **Management Information Systems**

Our primary management information system consists of an IBM AS/400 mainframe computer system, integrated computer interfaces and proprietary business operating software that we developed and which tracks salvage sales vehicles throughout the sales process. We call this proprietary business operating software the Copart Auction System ( CAS ) and have implemented CAS at all of our salvage storage facilities. In addition, we have integrated our mainframe computer system with Internet and Intranet systems in order to provide secure access to CAS data and images in a variety of formats.

Our auction-style service product, VB2, is served by an array of identical high-density, high-performance servers. Each individual sale is configured to run on an available server in the array and can be rapidly provisioned to any other available server in the array as required. Our sale, Internet and imaging services are load balanced across different geographical data centers.

We have invested in a production data center that is designed to run the business in the event of an emergency. The facility's electrical and mechanical systems are continually monitored. This facility is located in an area considered to be free of weather-related disasters and earthquakes.

### **Employees**

As of July 31, 2006, we had approximately 2,133 full-time employees, of whom approximately 282 were engaged in general and administrative functions and approximately 1,851 were engaged in yard operations. We are not currently subject to any collective bargaining agreements and believe our relationships with our employees are good.

### **Environmental Matters**

Our operations are subject to various laws and regulations regarding the protection of the environment. In the salvage vehicle sales industry, large numbers of wrecked vehicles are stored at facilities and, during that time, spills of fuel, motor oils and other fluids may occur, resulting in soil, surface water or groundwater contamination. Certain of our facilities store petroleum products and other hazardous materials in above-ground containment tanks and some of our facilities generate waste materials such as solvents or used oils that must be disposed of as non-hazardous or hazardous waste, as appropriate. We have implemented procedures to reduce the amount of soil contamination that may occur at our facilities, and we have initiated safety programs and training of personnel on the safe storage and handling of hazardous materials. We believe that we are in compliance, in all material respects, with all applicable environmental regulations and we do not anticipate any material capital expenditures to remain in environmental compliance.

In connection with the acquisition of our Dallas, Texas facility in 1994, we set aside \$3.0 million to cover the costs of environmental remediation, stabilization and related consulting expenses for a six-acre portion of the facility that contained elevated levels of lead due to the activities of the former operators. We began the stabilization process in 1996 and completed it in 1999. We paid all remediation and related costs from the \$3.0 million fund and, in accordance with the acquisition agreement, distributed the remainder of the fund to the seller of the Dallas facility, less \$.2 million which was held back to cover the costs of obtaining the no-further-action letter. In September 2002, our environmental engineering consultant issued a report, which concludes that the soil stabilization has effectively stabilized the lead-impacted soil, and that the concrete cap should prevent impact to storm water and subsequent surface water impact. Our consultant thereafter submitted an Operations and Maintenance

Plan ( Plan ) to the Texas Commission on Environmental Quality ( TCEQ ) providing for a two-year inspection and maintenance plan for the concrete cap, and a two-year ground and surface water monitoring plan. In January of 2003, the TCEQ approved the Plan, subject to the additions of upstream (background) surface water samples from the intermittent stream adjacent to the facility and documentation of any repairs to the concrete cap during the post closure-monitoring period. The first semi-annual water sampling was conducted in April 2003, which reflected that the lead-impacted, stabilized soil is not impacting the ground and/or surface water. The second round of semi-annual water samples collected in October and November 2003 reported concentration of lead in one storm water and one surface water sample in excess of the established upstream criteria for lead. In correspondence, which we received in July 2004, the TCEQ approved with comment our water monitoring report dated February 24, 2004. The TCEQ instructed us to continue with post-closure monitoring and maintenance activities and submit the next report in accordance with the approved schedules. In February 2005, a report from our environmental engineering consultant was transmitted to the TCEQ containing the results of annual monitoring activities consisting of two (2) semi-annual sampling events which occurred in April/June 2004 and October/November 2004. Laboratory analytical results indicated no lead concentrations exceeding the target concentration level set in the Corrective Measures Study for the site. The Company's environmental engineering consultant concluded in the February 2005 report to the TECQ that it is unlikely that lead concentrations detected in the stormwater runoff samples are attributable to the lead impacted soils. Based on the results of the 2004 samplings, we requested that no further action be taken and that a closure letter be issued by the TCEQ. We are not assured of receiving the no-further-action letter and we may incur further liabilities if the stabilization process proves ineffective. In addition, in 1994, we detected a small quantity of two hazardous substances in a temporary groundwater monitoring well at the Dallas facility. Our environmental consultants concluded that both substances arose from an off-site source and no further action was recommended.

We do not believe that any of the above environmental matters will, either individually or in the aggregate, have a material adverse effect on our financial position, results of operations or cash flows.

#### **Governmental Regulations**

Our operations are subject to regulation, supervision and licensing under various federal, provincial, state and local statutes, ordinances and regulations. The acquisition and sale of damaged and recovered stolen vehicles is regulated by state and provincial motor vehicle departments. In addition to the regulation of sales and acquisitions of vehicles, we are also subject to various local zoning requirements with regard to the location of our storage facilities. These zoning requirements vary from location to location. 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, provincial, state, and local governmental agencies in new markets.

#### **Legal Proceedings**

We are 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:

Ciano Dessources filed a lawsuit on May 21, 2003, in the Commonwealth of Massachusetts, Superior Court Department against Copart of Connecticut, Inc. and Copart, Inc. which purported to be a class action on behalf of persons whose vehicles were disposed of by us as abandoned vehicles, which the named plaintiff contends were disposed of without complying with state laws. Relief sought includes class certification, declaratory, remedial and/or injunctive relief, including the ordering of a



compliance program that will essentially protect consumers, as well as damages, fees, and costs. Copart's Motion for Summary Judgment was granted on December 8, 2004, dismissing the class claim element of the lawsuit. On August 9, 2006, Plaintiff's motion for summary judgment was denied. A trial date has not been set. Copart believes the claim is without merit, and intends to continue to defend the lawsuit vigorously.

On September 16, 2005, Richard M. Gray filed suit against Copart and A. Safrin, in the State Court for the County of Chatham, State of Georgia, alleging a class action for unreasonable amounts claimed for storage liens by Copart, and related claims. Relief sought included class certification, damages, fees, costs and expenses. Copart has filed a motion for summary judgment, the hearing for which has not been scheduled. Copart believes the claim is without merit, and intends to continue to defend the lawsuit vigorously.

On July 28, 2006, Foreign Car Sales and Service LLC filed suit against Copart in the United States District Court for the Middle District of Louisiana alleging antitrust violations and unfair trade practices. Relief sought is class certification, damages, fees, costs and expenses. Plaintiff is in pro per and is demanding a total award of the now current value of 51% of Copart issued stock. Copart believes the claim is without merit, and intends to defend the lawsuit vigorously.

On August 7, 2006, Kimberly and Jason Green filed suit against Copart in the Superior Court of the State of California, County of Sacramento, making allegations pursuant to a California consumer protection statute similar to a class action for unreasonable amounts claimed for storage liens by Copart, and related claims. Relief sought included class certification, damages, fees, costs and expenses. Copart filed an answer on September 1, 2006 denying the claim. Copart believes the claim is without merit, and intends to continue to defend this lawsuit vigorously.

On June 10, 2005, Manheim Services Corp. filed suit against Copart, Inc. in the United States District Court for the Northern District of Georgia, Atlanta Division, alleging infringement of Manheim's assigned patent (U.S. Patent No. 5,774,873). Relief sought included a patent infringement judgment, an injunction prohibiting us from using any infringing product or service (including VB2), damages, fees, costs and expenses. On August 3, 2005, we denied the claim and asserted counterclaims based on violations of antitrust laws and common-law tortious interference (the Competition Claims). On February 10, 2006, the District Court denied Manheim's motion to bifurcate the Competition Claims and stayed discovery on the Competition Claims through April 13, 2006. Additionally, on February 6, 2006, Manheim requested the Court to grant it leave to assert its additional alleged claims of infringement by us of Manheim's assigned U.S. Patent No. 6,006,201, The Court denied this request on May 30, 2006. On June 27, 2006, Manheim Services Corp dismissed all claims against us alleging patent infringement and we dismissed all of our counterclaims against Manheim Services Corp alleging antitrust violations. The matter was resolved amicably with express denials of liability from both parties.

We provide 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 our future results of operations cannot be predicted because any such effect depends on future results of operations, the amount and timing of the resolution of such matters. We believe that any ultimate liability will not have a material effect on our 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.

**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

**We depend on a limited number of major suppliers of salvage vehicles. The loss of one or more of these major suppliers 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 suppliers have accounted for a substantial portion of our revenues. In fiscal 2006, vehicles supplied by our two largest suppliers accounted for approximately 21% of our revenues. Supplier arrangements are either written or oral agreements typically subject to cancellation by either party upon 30 to 90 days notice. Vehicle suppliers 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 suppliers or that we will be able to retain our existing supply of salvage vehicles. A reduction in vehicles from a significant vehicle supplier or any material changes in the terms of an arrangement with a substantial vehicle supplier 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.

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

In fiscal 2004, we converted all our salvage sales from a live auction process to an entirely Internet-based auction-style model based on technology developed internally by us. The conversion represents a significant change in the way we conduct business and 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 United States, Netherlands, and Europe, but we cannot provide any

assurances that patents will actually issue or that, if issued, the patent could not later be found to be unenforceable or invalid.

**Our operating results were adversely affected by abnormal expenses associated with hurricanes Katrina and Rita during the year ended July 31, 2006, and our operating margins in future periods could be adversely affected by the hurricanes.**

During the year ended July 31, 2006, we recognized substantial additional costs associated with hurricanes Katrina and Rita. These additional costs, characterized as abnormal under FAS 151, were recognized during the year ended July 31, 2006, and include the additional subhauling, payroll, equipment and facilities expenses directly related to the operating conditions created by the hurricanes. We expect these costs to continue in future periods. These abnormal costs do not include the normal expenses associated with the increased unit volume created by the hurricanes, which are deferred until the sale of the unit and are reflected in vehicle pooling costs on the balance sheet. As of July 31, 2006, approximately 28% of the incremental salvage vehicles received as a result of the hurricanes remained unsold and in inventory. The Company expects that the majority of these vehicles will be disposed of primarily in the next two quarters. The Company's expectation that we will sell the balance of the unsold hurricane-related vehicles primarily within the next two quarters is based on management's current expectations, which assumes, among other things, that the Gulf Coast region will not experience any additional adverse weather events, including any additional hurricanes during the remainder of the 2006 hurricane season. The normal costs that have been capitalized will be recognized as yard expense as the vehicles are sold.

**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 salvage 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 our salvage yards beginning in the third quarter of fiscal 2004. 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 year.

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

Capacity at our salvage yards 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. For example, as discussed above, hurricanes Katrina and Rita had 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 salvage yards 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 suppliers of salvage vehicles, which could have an adverse effect on our operating results.

**Factors such as mild weather conditions in the United States can have an adverse effect on our revenues and operating results as well as our revenue and earnings growth rates.**

Mild weather conditions in the United States 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 suppliers and to compete more effectively in the market, each of which is subject to the other risks and uncertainties described in these sections.

**High fuel prices in the United States and Canada may have an adverse effect on our revenues and operating results as well as our earnings growth rates.**

Significant 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 PIP contracts 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 the insurance companies. A material increase in tow rates could have a material impact on our operating results.

**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 sales and auction companies with whom we compete directly in obtaining vehicles from insurance companies and other suppliers, 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 sales and auction companies and large dismantlers. Certain of our competitors may have greater financial resources than us. Due to the limited number of vehicle suppliers, the absence of long-term contractual commitments between us and our suppliers 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 suppliers. 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 salvage vehicle sales 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 suppliers 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 salvage vehicle sales facilities, the rate of growth of our business and revenues may decline if we are not able to successfully complete acquisitions and development of new facilities.**

We seek to increase our sales and profitability through the acquisition of other salvage vehicle sales facilities and the development of new salvage vehicle storage 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 salvage 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 is not only dependent 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 suppliers;
- identify and acquire or lease suitable premises on competitive terms;
- secure adequate capital; and
- maintain the supply of vehicles from vehicle suppliers.

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;
- 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 state or federal laws or regulations affecting salvage vehicles;
- changes in state 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 subhaulers 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 salvage storage facilities.

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.

**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 across our salvage operations has increased the relative importance of intellectual property rights to our business. Our intellectual property rights include pending patent applications for VB2 as well as trademarks, trade secrets, copyrights and other intellectual property rights. We are in the process of prosecuting an initial patent application relating to VB2 and cannot predict whether a patent will actually issue from that application. Even if a patent is issued, the scope of the protection gained may be insufficient or any issued patent could subsequently be deemed invalid or unenforceable. In addition, we are increasingly entering 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 abandoned live auctions. 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.

**New accounting pronouncements or new interpretations of existing standards could require us to make adjustments in our accounting policies that could adversely affect our financial statements.**

The Financial Accounting Standards Board, the Securities and Exchange Commission, or other accounting organizations or governmental entities issue new pronouncements or new interpretations of existing accounting standards that may require us to change our accounting policies and procedures. To date, we do not believe any new pronouncements or interpretations have had an adverse effect on our financial condition or results of operations, but future pronouncements or interpretations could require us to change our policies or procedures. Moreover, we continually review our critical accounting policies in light of the accounting literature and changes in our operations.

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

Participants in the salvage vehicle sales and auction industry are subject to, and may be required to expend funds to ensure compliance with a variety of U.S. or Canadian, federal, state, provincial and local 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, 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.

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

Our operations are subject to federal, state, provincial and local laws and regulations regarding the protection of the environment. In the salvage vehicle sales 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. 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 providers of fleet operations, our business could be harmed.**

We rely upon independent subhaulers to pick up and deliver vehicles to and from our storage facilities. 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 subhaulers, which may significantly increase our cost. These costs may not be passed on to our sellers or buyers.

**We are partially self-insured for certain losses.**

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 21% of our common stock as of July 31, 2006. 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.

**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.

**Compliance with new rules and regulations concerning corporate governance may be costly and time consuming.**

The Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley, requires, among other things, that companies adopt new corporate governance measures, imposes comprehensive reporting and disclosure requirements, sets stricter independence and financial expertise standards for board and audit committee members and imposes increased civil and criminal penalties for companies, their chief executive officers and chief financial officers for securities law violations. In addition, the Nasdaq Global Select Market, on which our common stock is traded, has adopted additional comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations will increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices, which could harm our results of operations and divert management's attention from business operations. These new rules and regulations may also make it more difficult and more expensive for us to obtain director and officer liability insurance and make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee.

#### *Executive Officers of the Registrant*

##### **Executive Officers**

Our executive officers and their ages as of July 31, 2006 were as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Willis J. Johnson	59	Chairman of the Board, Chief Executive Officer and Director
A. Jayson Adair	36	President and Director
James E. Meeks	56	Executive Vice President, Chief Operating Officer and Director
William E. Franklin	50	Senior Vice President and Chief Financial Officer
Paul A. Styer	50	Senior Vice President, General Counsel and Secretary
Vincent W. Mitz	43	Senior Vice President of Marketing
David L. Bauer	45	Senior Vice President of Information Technology and Chief Information Officer
Russell D. Lowy	47	Senior Vice President of Operations
Thomas E. Wylie	55	Senior Vice President of Human Resources
Simon E. Rote	34	Vice President of Finance

**Willis J. Johnson**, our founder, has served as our Chairman of the Board since 2004, Chief Executive Officer since 1986 and as a director since 1982. Mr. Johnson served as our President from 1986 until May 1995. Mr. Johnson was an officer and director of U-Pull-It, Inc. ( UPI ), a self-service auto dismantler which he co-founded in 1982, from 1982 through September 1994. Mr. Johnson sold his entire interest in UPI in September 1994. Mr. Johnson has over 30 years of experience in owning and operating auto dismantling companies.

**A. Jayson Adair** has served as our President since November 1996 and as a director since September 1992. From April 1995 until October 1996, Mr. Adair served as our Executive Vice President. From August 1990 until April 1995, Mr. Adair served as our Vice President of Sales and Operations and from June 1989 to August 1990, Mr. Adair served as our Manager of Operations.

**James E. Meeks** has served as our Vice President and Chief Operating Officer since September 1992 when he joined us concurrent with our purchase of South Bay Salvage Pool ( San Martin Operation ). Mr. Meeks has served as our Executive Vice President and director since October 1996 and as Senior Vice President since April 1995. From April 1986 to September 1992, Mr. Meeks, together with his family, owned and operated the San Martin Operation. Mr. Meeks was also an officer, director and part owner of Cas & Meeks, Inc., a towing and subhauling service company, which he operated from 1991 to March 2001. Mr. Meeks has over 30 years of experience in the vehicle dismantling business.

**William E. Franklin** has served as our Senior Vice President and Chief Financial Officer since March 2004. Mr. Franklin has over 20 years of international finance and executive management experience. From October 2001 to March 2004, he served as the Chief Financial Officer of Ptek Holdings, Inc., an international telecommunications company. Prior to that he was the President and CEO of Clifford Electronics, an international consumer electronics company. Mr. Franklin received a Master's degree in Business Administration from the University of Southern California and his Bachelor's of Science degree in Finance from California State University, Bakersfield. Mr. Franklin is a Certified Public Accountant.

**Paul A. Styer** has served as our General Counsel since September 1992, served as our Senior Vice President since April 1995 and as our Vice President from September 1992 until April 1995. Mr. Styer served as one of our directors from September 1992 until October 1993. Mr. Styer has served as our Secretary since October 1993. From August 1990 to September 1992, Mr. Styer conducted an independent law practice. Mr. Styer received a B.A. from the University of California, Davis and a J.D. from the University of the Pacific. Mr. Styer is a member of the California State Bar Association.

**Vincent W. Mitz** has served as our Senior Vice President of Marketing since May 1995. Prior thereto, Mr. Mitz was employed by NER Auction Systems from 1981 until its acquisition by Copart in 1995. At NER, Mr. Mitz held numerous positions culminating as Vice President of Sales and Operations for NER's New York region from 1990 to 1993 and Vice President of Sales & Marketing from 1993 to 1995.

**David L. Bauer** has served as our Senior Vice President of Information Technology and Chief Information Officer since joining Copart in December 1995. Prior thereto, Mr. Bauer was an independent systems consultant from 1987 to 1995. Prior to working independently, Mr. Bauer spent 1983 to 1987 working in Arthur Andersen & Company's Management Information Consulting Division, leaving in 1987 as a Consulting Manager. Mr. Bauer earned a B.A. in Economics from the University of California, San Diego in 1981 and an MBA from University of California, Davis in 1983.

**Russell D. Lowy** has served as our Senior Vice President of Operations since July 2002. Mr. Lowy served as Vice President of Operations, Eastern Division from December 1999 to July 2002. From December 1998 to December 1999, Mr. Lowy served as Director of Training and Auditing. Mr. Lowy served as Assistant Vice President of Operations from 1996 to 1997, Regional Manager of Northern California from 1995 to 1996 and Marketing

Manager from 1993 to 1994. Prior to joining us, Mr. Lowy spent

nine years with ADP Claims Solutions Group. Mr. Lowy received a B.S. in Business Administration from California State University, Chico in 1982.

**Thomas E. Wylie** has served as our Senior Vice President of Human Resources since September 2003. Mr. Wylie has over 25 years of human resources and organizational change management experience. From January 2001 to November 2003 he served as Vice President, Human Resources, Systems and Administration for the California Division of Kaiser Permanente, a health care organization headquartered in Oakland, California. Prior to that he was the Vice President of Human Resources for Global Business Services, a division of Honeywell International in Morristown, New Jersey. He held several other positions with Honeywell starting in 1979. Mr. Wylie received a bachelor's degree from Hamline University in St. Paul, Minnesota.

**Simon E. Rote** has served as our Vice President of Finance since March 2003. Prior thereto, Mr. Rote served as our Controller from December 1998 to March 2003, and as our Assistant Controller from December 1997 to December 1998. Mr. Rote was an auditor with KPMG LLP from 1994 to 1997. Mr. Rote received a B.S. in Accounting from St. Mary's College in 1994.

Our executive officers are elected by our board of directors and serve at the discretion of the board. There are no family relationships among any of our directors or executive officers, except that A. Jayson Adair is the son-in-law of Willis J. Johnson.

**Item 1B.** *Unresolved Staff Comments*

Not Applicable.

**Item 2.** *Properties*

Our corporate headquarters are located in Fairfield, California. This facility consists of approximately 100,000 square feet of office space owned by Copart. We also own or lease an additional 122 operating facilities. In the United States we have facilities in every state except Delaware, New Hampshire, North Dakota, Rhode Island, South Dakota, Vermont and Wyoming. In Canada we are only in the province of Ontario. We believe that our existing facilities are adequate to meet current requirements and that suitable additional or substitute space will be available as needed to accommodate any expansion of operations and additional offices.

**Item 3.** *Legal Proceedings*

We are 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:

Ciano Dessources filed a lawsuit on May 21, 2003, in the Commonwealth of Massachusetts, Superior Court Department against Copart of Connecticut, Inc. and Copart, Inc. which purported to be a class action on behalf of persons whose vehicles were disposed of by us as abandoned vehicles, which the named plaintiff contends were disposed of without complying with state laws. Relief sought includes class certification, declaratory, remedial and/or injunctive relief, including the ordering of a compliance program that will essentially protect consumers, as well as damages, fees, and costs. Copart's Motion for Summary Judgment was granted on December 8, 2004, dismissing the class claim element of the lawsuit. On August 9, 2006, Plaintiff's motion for summary judgment was denied. A trial date has not been set. Copart believes the claim is without merit, and intends to continue to defend the lawsuit vigorously.

On September 16, 2005, Richard M. Gray filed suit against Copart and A. Safrin, in the State Court for the County of Chatham, State of Georgia, alleging a class action for unreasonable amounts claimed for storage liens by Copart, and related claims. Relief sought included class certification, damages, fees, costs and expenses. Copart has filed a motion for summary judgment, the

hearing for which has not been scheduled. Copart believes the claim is without merit, and intends to continue to defend the lawsuit vigorously.

On July 28, 2006, Foreign Car Sales and Service LLC filed suit against Copart in the United States District Court for the Middle District of Louisiana alleging antitrust violations and unfair trade practices. Relief sought is class certification, damages, fees, costs and expenses. Plaintiff is in pro per and is demanding a total award of the now current value of 51% of Copart issued stock. Copart believes the claim is without merit, and intends to defend the lawsuit vigorously.

On August 7, 2006, Kimberly and Jason Green filed suit against Copart in the Superior Court of the State of California, County of Sacramento, making allegations pursuant to a California consumer protection statute similar to a class action for unreasonable amounts claimed for storage liens by Copart, and related claims. Relief sought included class certification, damages, fees, costs and expenses. Copart filed an answer on September 1, 2006 denying the claim. Copart believes the claim is without merit and intends to continue to defend this lawsuit vigorously.

On June 10, 2005, Manheim Services Corp. filed suit against Copart, Inc. in the United States District Court for the Northern District of Georgia, Atlanta Division, alleging infringement of Manheim's assigned patent (U.S. Patent No. 5,774,873). Relief sought included a patent infringement judgment, an injunction prohibiting us from using any infringing product or service (including VB2), damages, fees, costs and expenses. On August 3, 2005, we denied the claim and asserted counterclaims based on violations of antitrust laws and common-law tortious interference (the Competition Claims). On February 10, 2006, the District Court denied Manheim's motion to bifurcate the Competition Claims and stayed discovery on the Competition Claims through April 13, 2006. Additionally, on February 6, 2006, Manheim requested the Court to grant it leave to assert its additional alleged claims of infringement by us of Manheim's assigned U.S. Patent No. 6,006,201, The Court denied this request on May 30, 2006. On June 27, 2006, Manheim Services Corp dismissed all claims against us alleging patent infringement and we dismissed all of our counterclaims against Manheim Services Corp alleging antitrust violations. The matter was resolved amicably with express denials of liability from both parties.

We provide 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 our future results of operations cannot be predicted because any such effect depends on future results of operations, the amount and timing of the resolution of such matters. We believe that any ultimate liability will not have a material effect on our 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.

**Item 4. *Submission of Matters to a Vote of Security Holders***

We did not submit any matters to a vote of our shareholders during the fourth quarter of our 2006 fiscal year.

**PART II****Item 5. *Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities*****Market Information**

The following table summarizes the high and low sales prices per share of our common stock for each quarter during the last two fiscal years. As of July 31, 2006, there were 90,445,208 shares outstanding. Our common stock has been quoted on the Nasdaq under the symbol "CPRT" since March 17, 1994. As of July 31, 2006, we had 1,521 shareholders of record.

<b>Fiscal Year 2006</b>	<b>High</b>	<b>Low</b>
Fourth Quarter	27.92	23.51
Third Quarter	27.86	24.70
Second Quarter	25.80	21.14
First Quarter	25.50	22.00
<b>Fiscal Year 2005</b>	<b>High</b>	<b>Low</b>
Fourth Quarter	26.21	21.65
Third Quarter	25.99	21.00
Second Quarter	27.33	18.40
First Quarter	23.40	17.70

**Dividend Policies**

We have not paid a cash dividend since becoming a public company in 1994. We currently intend to retain any earnings for use in our business and do not anticipate paying any cash dividends in the foreseeable future.

We expect to continue to use cash flows from operations to finance our working capital needs and to develop and grow our business. In addition to our stock repurchase, we are considering a variety of alternative potential uses for our remaining cash balances and our cash flow from operations. These alternative potential uses include additional stock repurchases, the payment of dividends and acquisitions.

**Stock Repurchase**

In February 2003, our Board of Directors authorized us to repurchase up to 9.0 million shares of our common stock. 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. The repurchases will be made at such times and in such amounts as we deem appropriate and may be discontinued at any time. For the year ended July 31, 2006, we repurchased 366,000 shares at a weighted average price of \$24.24. For the year ended July 31, 2005, we did not repurchase any shares. The total number of shares repurchased under the program as of July 31, 2006 is approximately 4.0 million, leaving approximately 5.0 million available under the repurchase program.



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The number and average price of shares purchased in each fiscal year are set forth in the table below:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares That May Yet Be Purchased Under the Program
<i>Fiscal 2006</i>				
First Quarter				
Second Quarter	366,000	\$ 24.24	4,038,300	4,961,700
Third Quarter				
Fourth Quarter				
<i>Fiscal 2005</i>				
First Quarter				
Second Quarter				
Third Quarter				
Fourth Quarter				

### Issuances of Unregistered Securities

There were no issuances of unregistered securities in the quarter ended July 31, 2006.

### Item 6. Selected Financial Data

The following selected operating and balance sheet data, as of and for the years ended July 31, 2006, 2005 and 2004 have been derived from the audited consolidated financial statements of the Company. The following selected operating and balance sheet data, as of and for the years ended July 31, 2003 and 2002 have been derived from unaudited consolidated financial statements of the Company. The selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's consolidated financial statements and the notes thereto.

	Fiscal Year Ending July 31,				
	2006	2005	2004	2003	2002
	(In 000s except per share and other data)				
<b>Operating Data</b>					
Revenues	\$ 528,571	\$ 447,731	\$ 391,014	\$ 335,407	\$ 306,472
Operating Income	171,562	156,436	124,461	90,638	89,724
Income from continuing operations before income taxes	174,522	164,595	129,921	93,994	94,848
Income tax expense	(61,862 )	(62,772 )	(50,929 )	(36,877 )	(36,727 )
Income from continuing operations	112,660	101,823	78,992	57,117	58,121
Income (loss) from discontinued operations, net of income tax effects	(15,713 )	293	228	105	689
Net income	96,947	102,116	79,220	57,222	57,389
Basic per share amounts:					
Income from continuing operations	\$ 1.24	\$ 1.13	\$ 0.89	\$ 0.63	\$ 0.65
Discontinued operations	\$ (0.17 )	\$	\$	\$	\$

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