

COPART INC

Form 10-Q

February 28, 2019

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## UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

### FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
for the quarterly period ended January 31, 2019

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: 000-23255

### COPART INC

(Exact name of registrant as specified in its charter)

Delaware 94-2867490

(State or other jurisdiction (IRS Employer  
of incorporation or organization) Identification No.)

14185 Dallas Parkway, Suite 300, Dallas, Texas 75254

(Address of principal executive offices, including zip code)

(972) 391-5000

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

YES  NO

As of February 27, 2019, 228,205,906 shares of the registrant’s common stock were outstanding.

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Copart, Inc.

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January 31, 2019

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**Copart, Inc.**  
**Consolidated Balance Sheets**  
**(Unaudited)**

(In thousands, except share amounts)

	January 31, 2019	July 31, 2018
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 108,174	\$ 274,520
Accounts receivable, net	393,561	351,601
Vehicle pooling costs	80,610	34,284
Inventories	28,315	16,734
Income taxes receivable	25	15,312
Prepaid expenses and other assets	17,781	16,665
Total current assets	628,466	709,116
Property and equipment, net	1,237,117	1,163,425
Intangibles, net	60,265	64,892
Goodwill	338,045	337,235
Deferred income taxes	348	470
Other assets	32,664	32,560
Total assets	\$ 2,296,905	\$ 2,307,698
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 266,126	\$ 270,944
Deferred revenue	7,344	4,488
Income taxes payable	4,441	673
Current portion of revolving loan facility and capital lease obligations	94,122	1,151
Total current liabilities	372,033	277,256
Deferred income taxes	32,314	19,733
Income taxes payable	30,390	27,277
Long-term debt, revolving loan facility and capital lease obligations, net of discount	398,740	398,747
Other liabilities	3,475	3,586
Total liabilities	836,952	726,599
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: \$0.0001 par value - 5,000,000 shares authorized; none issued	—	—
Common stock: \$0.0001 par value - 400,000,000 shares authorized; 226,700,670 and 233,898,841 shares issued and outstanding, respectively.	23	23
Additional paid-in capital	530,102	526,858
Accumulated other comprehensive loss	(107,223 )	(107,928 )
Retained earnings	1,037,051	1,162,146
Total stockholders' equity	1,459,953	1,581,099
Total liabilities and stockholders' equity	\$ 2,296,905	\$ 2,307,698

The accompanying notes are an integral part of these consolidated financial statements.



**Copart, Inc.**  
**Consolidated Statements of Income**  
**(Unaudited)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>January 31,</b>		<b>January 31,</b>	
<u>(In thousands, except per share amounts)</u>	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
Service revenues and vehicle sales:				
Service revenues	\$ 416,807	\$ 401,954	\$ 811,613	\$ 776,079
Vehicle sales	68,091	57,152	134,653	102,195
Total service revenues and vehicle sales	484,898	459,106	946,266	878,274
Operating expenses:				
Yard operations	215,460	217,184	423,154	434,791
Cost of vehicle sales	61,212	50,313	118,968	88,610
General and administrative	43,487	40,662	87,965	79,984
Total operating expenses	320,159	308,159	630,087	603,385
Operating income	164,739	150,947	316,179	274,889
Other (expense) income:				
Interest expense	(5,233 )	(5,758 )	(9,884 )	(11,353 )
Interest income	678	197	1,638	394
Other income (expense), net	4,782	(948 )	5,819	(5,364 )
Total other income (expense)	227	(6,509 )	(2,427 )	(16,323 )
Income before income taxes	164,966	144,438	313,752	258,566
Income tax expense	33,593	41,137	68,296	77,705
Net income	131,373	103,301	245,456	180,861
Net income attributable to noncontrolling interest	—	45	—	90
Net income attributable to Copart, Inc.	\$ 131,373	\$ 103,256	\$ 245,456	\$ 180,771
Basic net income per common share	\$0.57	\$0.45	\$1.06	\$0.78
Weighted average common shares outstanding	230,798	231,478	232,343	231,086
Diluted net income per common share	\$0.55	\$0.43	\$1.01	\$0.75
Diluted weighted average common shares outstanding	240,660	241,360	242,743	240,076

The accompanying notes are an integral part of these consolidated financial statements.

**Copart, Inc.**  
**Consolidated Statements of Comprehensive Income**  
**(Unaudited)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>January 31,</b>		<b>January 31,</b>	
<u>(In thousands)</u>	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
Comprehensive income, net of tax:				
Net income	\$ 131,373	\$ 103,301	\$ 245,456	\$ 180,861
Other comprehensive income:				
Foreign currency translation adjustments	8,423	23,243	705	21,763
Comprehensive income	139,796	126,544	246,161	202,624
Comprehensive income attributable to noncontrolling interest	—	45	—	90
Comprehensive income attributable to Copart, Inc.	\$ 139,796	\$ 126,499	\$ 246,161	\$ 202,534

The accompanying notes are an integral part of these consolidated financial statements.

**Copart, Inc.**  
**Consolidated Statements of Stockholder's Equity**  
**(Unaudited)**

<u>(in thousands, except share amounts)</u>	Common Stock		Additional	Accumulated	Retained	Noncontrolling	Stockholders'
	Outstanding	Amount	Paid in	Other	Earnings	Interest	Equity
	Shares		Capital	Comprehensive			
				Income (Loss)			
<b>Balances at July 31, 2018</b>	233,898,841	\$ 23	\$526,858	\$ (107,928 )	\$ 1,162,146	\$ —	\$ 1,581,099
Net income	—	—	—	—	114,083	—	114,083
Currency translation adjustment	—	—	—	(7,718 )	—	—	(7,718 )
Cumulative effect of change in accounting principle	—	—	—	—	(22,954 )	—	(22,954 )
Exercise of stock options, net of repurchased shares	109,321	—	1,229	—	(2 )	—	1,227
Stock-based compensation	—	—	6,021	—	—	—	6,021
<b>Balances at October 31, 2018</b>	234,008,162	23	534,108	(115,646 )	1,253,273	—	1,671,758
Net income	—	—	—	—	131,373	—	131,373
Currency translation adjustment	—	—	—	8,423	—	—	8,423
Exercise of stock options, net of repurchased shares	241,896	—	3,991	—	(25 )	—	3,966
Stock-based compensation	—	—	5,929	—	—	—	5,929
Shares issued for Employee Stock Purchase Plan	86,208	—	3,501	—	—	—	3,501
Shares repurchased	(7,635,596 )	—	(17,427 )	—	(347,570 )	—	(364,997 )
<b>Balances at January 31, 2019</b>	226,700,670	\$ 23	\$ 530,102	\$ (107,223 )	\$ 1,037,051	\$ —	\$ 1,459,953

The accompanying notes are an integral part of these consolidated financial statements.

**Copart, Inc.**  
**Consolidated Statements of Stockholder's Equity**  
**Continued**  
**(Unaudited)**

<u>(in thousands, except share amounts)</u>	Common Stock		Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Noncontrolling Interest	Stockholders' Equity
	Outstanding Shares	Amount					
<b>Balances at July 31, 2017</b>	230,488,296	\$ 23	\$ 453,349	\$ (100,676 )	\$ 745,370	\$ 534	\$ 1,098,600
Net income	—	—	—	—	77,515	45	77,560
Currency translation adjustment	—	—	—	(1,480 )	—	—	(1,480 )
Exercise of stock options, net of repurchased shares	730,323	—	9,253	—	(3 )	—	9,250
Stock-based compensation	—	—	5,307	—	—	—	5,307
<b>Balances at October 31, 2017</b>	231,218,619	23	467,909	(102,156 )	822,882	579	1,189,237
Net income	—	—	—	—	103,256	45	103,301
Currency translation adjustment	—	—	—	23,243	—	—	23,243
Distributions to noncontrolling interest	—	—	—	—	—	(55 )	(55 )
Exercise of stock options, net of repurchased shares	508,285	—	7,349	—	—	—	7,349
Stock-based compensation	—	—	5,968	—	24	—	5,992
Shares issued for Employee Stock Purchase Plan	100,708	—	2,723	—	—	—	2,723
<b>Balances at January 31, 2018</b>	231,827,612	\$ 23	\$ 483,949	\$ (78,913 )	\$ 926,162	\$ 569	\$ 1,331,790

The accompanying notes are an integral part of these consolidated financial statements.

**Copart, Inc.**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**

	<b>Six Months Ended</b>	
	<b>January 31,</b>	
<u>(In thousands)</u>	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 245,456	\$ 180,861
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, including debt cost	42,487	33,994
Allowance for doubtful accounts	96	1,013
Equity in (earnings) losses of unconsolidated affiliates	(514 )	251
Stock-based compensation	11,950	11,298
(Gain) loss on sale of property and equipment	(3,890 )	4,639
Deferred income taxes	6,632	2,666
Changes in operating assets and liabilities:		
Accounts receivable	(86,125 )	(86,147 )
Vehicle pooling costs	(20,218 )	(6,548 )
Inventories	(11,640 )	(2,525 )
Prepaid expenses and other current assets	(1,220 )	(1,437 )
Other assets	495	(4,320 )
Accounts payable and accrued liabilities	7,338	38,919
Deferred revenue	2,843	1,705
Income taxes receivable	15,286	2,575
Income taxes payable	6,890	9,365
Other liabilities	(662 )	84
Net cash provided by operating activities	215,204	186,393
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(136,727 )	(110,905 )
Proceeds from sale of property and equipment	17,488	2,812
Purchase of assets in connection with acquisitions	—	123
Net cash used in investing activities	(119,239 )	(107,970 )
<b>Cash flows from financing activities:</b>		
Proceeds from the exercise of stock options	5,220	16,603
Proceeds from the issuance of Employee Stock Purchase Plan shares	3,501	2,723
Repurchases of common stock	(364,997 )	—
Payments for employee stock-based tax withholdings	(27 )	(3 )
Net proceeds (repayments) on revolving loan facility	93,300	(120,300 )
Distributions to noncontrolling interest	—	(55 )
Net cash used in financing activities	(263,003 )	(101,032 )
Effect of foreign currency translation	692	7,809
Net decrease in cash and cash equivalents	(166,346 )	(14,800 )
Cash and cash equivalents at beginning of period	274,520	210,100
Cash and cash equivalents at end of period	\$ 108,174	\$ 195,300
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid	\$ 9,018	\$ 11,010
Income taxes paid, net of refunds	\$ 39,327	\$ 64,104

The accompanying notes are an integral part of these consolidated financial statements.



**Copart, Inc.****Notes to Consolidated Financial Statements****January 31, 2019****(Unaudited)****NOTE 1 – Summary of Significant Accounting Policies*****Basis of Presentation and Description of Business***

Copart, Inc. (the Company) provides vehicle sellers with a full range of services to process and sell vehicles over the internet through the Company's Virtual Bidding Third Generation (VB3) internet auction-style sales technology. Sellers are primarily insurance companies but also include banks, finance companies, charities, fleet operators, dealers and vehicles sourced directly from individual owners. The Company sells principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers, and exporters; however, at certain locations, the Company sells directly to the general public. The majority of vehicles sold on behalf of insurance companies are either damaged vehicles deemed a total loss or not economically repairable by the insurance companies or are recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. The Company offers vehicle sellers a full range of services that expedite each stage of the vehicle sales process, minimize administrative and processing costs and maximize the ultimate sales price through the online auction process. In the United States (U.S.), Canada, Brazil, the Republic of Ireland, Finland, the United Arab Emirates (U.A.E.), Oman, Bahrain, and Spain, the Company sells vehicles primarily as an agent and derives revenue primarily from auction and auction related sales transaction fees charged for vehicle remarketing services as well as fees for services subsequent to the auction, such as delivery and storage. In the United Kingdom (U.K.) and Germany, the Company operates both as an agent and on a principal basis, in some cases purchasing the salvage vehicles outright and reselling the vehicles for its own account. In Germany and Spain, the Company also derives revenue from listing vehicles on behalf of insurance companies and insurance experts to determine the vehicle's residual value and/or to facilitate a sale for the insured.

***Principles of Consolidation***

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments of a normal recurring nature considered necessary for fair presentation of its financial position as of January 31, 2019 and July 31, 2018, its consolidated statements of income and comprehensive income for the three and six months ended January 31, 2019 and 2018, and its cash flows for the six months ended January 31, 2019 and 2018. Interim results for the three and six months ended January 31, 2019 are not necessarily indicative of the results that may be expected for any future period, or for the entire year ending July 31, 2019. These consolidated financial statements have been prepared in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The interim consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2018. Certain prior year amounts have been reclassified to conform to current year presentation.

The consolidated financial statements of the Company include the accounts of the parent company and its wholly-owned subsidiaries, including its foreign wholly-owned subsidiaries. The Company also had a 59.5% voting interest in a company, which was acquired as part of the Cycle Express, LLC acquisition ("majority-owned subsidiary"), which provided various repossession services for the powersports auction industry. The noncontrolling interest consisted of a 40.5% outside voting interest in the majority-owned subsidiary. Net income or loss of the majority-owned subsidiary was allocated to the members' interests in accordance with the operating agreement. During the year ended July 31, 2018, the Company sold the majority-owned subsidiary. Significant intercompany transactions and balances have been eliminated in consolidation.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates include, but are not limited to, vehicle pooling costs; income taxes; stock-based compensation; purchase price allocations; and contingencies. Actual results could differ

from these estimates.

**Revenue Recognition**

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* (“ASC 606”), which superseded the revenue recognition requirements in ASC 605, *Revenue Recognition* (“ASC 605”). ASC 606 revised the timing of revenue recognition based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASC 606 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. On August 1, 2018, the Company adopted ASC 606 using the modified retrospective method for all contracts. Results for reporting periods beginning August 1,



2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the Company's historic accounting under ASC 605.

Under the new standard, the Company concluded its primary performance obligation is the auctioning of consigned vehicles through an online auction process. Upon adoption of ASC 606, service revenue and vehicle sales revenue are recognized at the date the vehicles are sold at auction, excluding annual registration fees. This timing of revenue recognition under ASC 606 represents a change in the timing of revenue recognition for certain service revenues, such as inbound transportation and titling fees, which were recognized under ASC 605 prior to auction, when the services were performed. Under ASC 606, costs to prepare the vehicles for auction, including inbound transportation costs and titling fees, are deferred and recognized at the time of revenue recognition at auction. The Company calculated the impact of the adoption on the consolidated financial statements, which resulted in a decrease to opening retained earnings, net of tax, as of August 1, 2018, of \$23.0 million as a result of the initial application of the standard and did not have a material impact to earnings for the three and six months ended January 31, 2019. This retained earnings impact related to adjustments to accounts receivable, vehicle pooling costs and deferred taxes upon adoption of the standard.

There were no contract liabilities on the consolidated balance sheets at January 31, 2019. The Company's disaggregation between service revenues and vehicle sales at the segment level reflects how the nature, timing, amount and uncertainty of its revenues and cash flows are impacted by economic factors. The Company reports sales taxes on relevant transactions on a net basis in the Company's consolidated results of operations, and therefore does not include sales taxes in revenues or costs.

#### *Service revenues*

The Company's service revenue consists of auction and auction related sales transaction fees charged for vehicle remarketing services. Within this revenue category, the Company's primary performance obligation is the auctioning of consigned vehicles through an online auction process. These auction and auction related services may include a combination of vehicle purchasing fees, vehicle listing fees, and vehicle selling fees that can be based on a predetermined percentage of the vehicle sales price, tiered vehicle sales price driven fees, or at a fixed fee based on the sale of each vehicle regardless of the selling price of the vehicle; transportation fees for the cost of transporting the vehicle to or from the Company's facility; title processing and preparation fees; vehicle storage fees; bidding fees; and vehicle loading fees. These services are not distinct within the context of the contract. Accordingly, revenue for these services is recognized when the single performance obligation is satisfied at the completion of the auction process. The Company does not take ownership of these consigned vehicles, which are stored at the Company's facilities located throughout the U.S. and at its international locations. These fees are recognized as net revenue (not gross vehicle selling price) at the time of auction in the amount of such fees charged.

The Company identified a separate performance obligation related to providing access to its online auction platform. The Company charges members an annual registration fee for the right to participate in its online auctions and access the Company's bidding platform. Under the new standard, this fee will continue to be recognized ratably over the term of the arrangement, generally one year, as each day of access to the online auction platform represents the best depiction of the transfer of the service.

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

<u>(In thousands)</u>	Three Months Ended January 31, 2019			Three Months Ended January 31, 2018		
	United States	International	Total	United States	International	Total
Service revenues	\$362,023	\$ 54,784	\$416,807	\$355,542	\$ 46,412	\$401,954

<u>(In thousands)</u>	Six Months Ended January 31, 2019			Six Months Ended January 31, 2018		
	United States	International	Total	United States	International	Total
Service revenues	\$705,596	\$ 106,017	\$811,613	\$686,933	\$ 89,146	\$776,079

#### *Vehicle sales*

Certain vehicles are purchased and remarketed on the Company's own behalf. The Company identified a single

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performance obligation related to the sale of these vehicles, which is the completion of the online auction process. Under the new standard, vehicle sales revenue will continue to be recognized on the auction date. As the Company acts as a principal in vehicle sales transactions, the gross sales price at auction is recorded as revenue.

<u>(In thousands)</u>	Three Months Ended January 31, 2019			Three Months Ended January 31, 2018		
	United States	International	Total	United States	International	Total
Vehicle sales	\$28,049	\$ 40,042	\$68,091	\$29,593	\$ 27,559	\$57,152

<u>(In thousands)</u>	Six Months Ended January 31, 2019			Six Months Ended January 31, 2018		
	United States	International	Total	United States	International	Total
Vehicle sales	\$55,685	\$ 78,968	\$134,653	\$49,307	\$ 52,888	\$102,195

**Contract assets**

The Company capitalizes certain contract assets related to obtaining a contract, where the amortization period for the related asset is greater than one year. These assets are amortized over the expected life of the customer relationship. Contract assets are classified as current or long-term other assets, based on the timing of when the Company expects to recognize the related revenues and are amortized as an offset to the associated revenues on a straight-line basis. The Company assesses these costs for impairment at least quarterly and as “triggering” events occur that indicate it is more likely than not that an impairment exists. The contract asset costs where the amortization period for the related asset is one year or less are expensed as incurred and recorded within general and administrative expenses in the accompanying statements of income.

The change in the carrying amount of contract assets was as follows (in thousands):

Balance as of July 31, 2018	\$11,840
Costs amortized during the period	(3,322 )
Effect of foreign currency exchange rates	(46 )
Balance as of January 31, 2019	\$8,472

**Vehicle Pooling Costs**

The Company defers costs that relate directly to the fulfillment of its contracts associated with vehicles consigned to and received by the Company, but not sold as of the end of the period. The Company quantifies the deferred costs using a calculation that includes the number of vehicles at its facilities at the beginning and end of the period, the number of vehicles sold during the period and an allocation of certain yard operation costs of the period. The primary expenses allocated and deferred are inbound transportation costs, titling fees, certain facility costs, labor, and vehicle processing. Upon the adoption of ASC 606, the Company began deferring the inbound transportation costs and titling fees directly associated with the vehicles within its vehicle pooling costs. If the allocation factors change, then yard operation expenses could increase or decrease correspondingly in the future. These costs are expensed as vehicles are sold in subsequent periods on an average cost basis. Given the fixed cost nature of the Company’s business, there are no direct correlations for increases in expenses or units processed on vehicle pooling costs.

**Foreign Currency Translation**

The Company records foreign currency translation adjustments from the process of translating the functional currency of the financial statements of its foreign subsidiaries into the U.S. dollar reporting currency. The Canadian dollar, British pound, Brazilian real, European Union euro, U.A.E. dirham, Omani rial, Bahraini dinar, and Indian rupee are the functional currencies of the Company’s foreign subsidiaries as they are the primary currencies within the economic environment in which each subsidiary operates. The original equity investment in the respective subsidiaries is translated at historical rates. Assets and liabilities of the respective subsidiary’s operations are translated into U.S. dollars at period-end exchange rates, and revenues and expenses are translated into U.S. dollars at average exchange rates in effect during each reporting period. Adjustments resulting from the translation of each subsidiary’s financial statements are reported in other comprehensive income.

The cumulative effects of foreign currency exchange rate fluctuations were as follows (in thousands):

Cumulative loss on foreign currency translation as of July 31, 2017	\$(100,676 )
Loss on foreign currency translation	(7,252 )
Cumulative loss on foreign currency translation as of July 31, 2018	\$(107,928 )
Gain on foreign currency translation	705
Cumulative loss on foreign currency translation as of January 31, 2019	\$(107,223 )

**Income Taxes and Deferred Tax Assets**

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

benefits and deficiencies related to exercises of stock options are recognized as expense or benefit in the income statement as discrete items in the reporting period in which they occur.

In accordance with the provisions of ASC 740, *Income Taxes*, a two-step approach is applied to the recognition and measurement of uncertain tax positions taken or expected to be taken in a tax return. The first step is to determine if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained in an audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax position as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The Company recognizes interest and penalties related to uncertain tax positions in the provision for income taxes on its consolidated statements of income.

The Company accounted for the tax effects of the Tax Cuts and Jobs Act, enacted on December 22, 2017, on a provisional basis in the six months ended January 31, 2018 consolidated financial statements. The Company completed its accounting as of January 31, 2019, within the one year measurement period from the enactment date.

***Cash and Cash Equivalents***

The Company considers all highly liquid investments purchased with original maturities of three months or less at the time of purchase to be cash equivalents. Cash and cash equivalents include cash held in checking, domestic certificates of deposit, and money market accounts. The Company periodically invests its excess cash in money market funds and U.S. Treasury Bills. The Company's cash and cash equivalents are placed with high credit quality financial institutions.

***Other Assets***

Other assets consist of long-term deposits, contracted prepayments, notes receivable, and investments in unconsolidated affiliates. In accordance with ASC 323, *Investments-Equity Method and Joint Ventures*, the Company uses the equity method to account for investments in joint ventures and other unconsolidated entities if the Company has the ability to exercise significant influence over the financial and operating policies of those investees. Under the equity method, the Company records the initial investment in an entity at cost and subsequently adjusts the investment for the Company's share of the affiliate's undistributed earnings (losses) and distributions recorded in other income. The Company reviews the carrying amount of the investments in unconsolidated affiliates annually, or whenever circumstances indicate that the value of these investments may have declined. If the Company determines an investment is impaired on an other-than-temporary basis, a loss equal to the difference between the fair value of the investment and its carrying amount is recorded.

***Fair Value of Financial Instruments***

The Company records its financial assets and liabilities at fair value in accordance with the framework for measuring fair value in U.S. GAAP. In accordance with ASC 820, *Fair Value Measurements and Disclosures*, as amended by Accounting Standards Update 2011-04, the Company considers fair value as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants under current market conditions. This framework establishes a fair value hierarchy that prioritizes the inputs used to measure fair value:

- Level I    Observable inputs that reflect unadjusted quoted prices for identical assets or liabilities traded in active markets.
- Level II    Inputs other than quoted prices included within Level I that are observable for the asset or liability, either directly or indirectly.
- Level III    Inputs that are generally unobservable. These inputs may be used with internally developed methodologies that result in management's best estimate.

The amounts recorded for financial instruments in the Company's consolidated financial statements, which included cash, accounts receivable, accounts payable, accrued liabilities and Revolving Loan Facility approximated their fair values as of January 31, 2019 and July 31, 2018, due to the short-term nature of those instruments, and are classified within Level II of the fair value hierarchy. Cash equivalents are classified within Level II of the fair value hierarchy because they are valued using quoted market prices of the underlying investments. See *Note 3 – Long-Term Debt*, and *Note 5 – Fair Value Measures*.

***Capitalized Software Costs***

The Company capitalizes system development costs and website development costs related to enterprise computing services during the application development stage. Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its

estimated useful life, generally three years. The Company evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that impact the recoverability of these assets.

Total gross capitalized software as of January 31, 2019 and July 31, 2018 was \$34.3 million and \$30.7 million, respectively. Accumulated amortization expense related to software as of January 31, 2019 and July 31, 2018 totaled \$19.3 million and \$16.0 million, respectively.

**Acquisitions**

The Company recognizes and measures identifiable assets acquired and liabilities assumed in acquired entities in accordance with ASC 805, *Business Combinations*. The allocation of the purchase consideration for acquisitions can require extensive use of accounting estimates and judgments to allocate the purchase consideration to the identifiable tangible and intangible assets acquired and liabilities assumed based on their respective fair values. The excess of the fair value of purchase consideration over the values of the identifiable assets and liabilities is recorded as goodwill. Critical estimates in valuing certain identifiable assets include but are not limited to expected long-term revenues; future expected operating expenses; cost of capital; appropriate attrition; and discount rates.

**Segments and Other Geographic Reporting**

The Company's U.S. and International regions are considered two separate operating segments and are disclosed as two reportable segments. The segments represent geographic areas and reflect how the chief operating decision maker allocates resources and measures results, including total revenues, operating income and income before income taxes.

**NOTE 2 — Accounts Receivable, Net**

Accounts receivable, net consisted of:

<u>(In thousands)</u>	January 31, 2019	July 31, 2018
Advance charges receivable	\$312,165	\$230,092
Trade accounts receivable	84,290	125,255
Other receivables	2,646	1,698
	399,101	357,045
Less: Allowance for doubtful accounts	(5,540 )	(5,444 )
Accounts receivable, net	\$393,561	\$351,601

Advance charges receivable represents amounts paid to third parties on behalf of insurance companies for which the Company will be reimbursed when the vehicle is sold. As advance charges are recovered within one year, the Company has not adjusted the amount of consideration received from the customer for a significant financing component. Trade accounts receivable includes fees and gross auction proceeds to be collected from insurance companies and buyers.

**NOTE 3 – Long-Term Debt****Credit Agreement**

On December 3, 2014, the Company entered into a Credit Agreement (as amended from time to time, the "Credit Amendment") with Wells Fargo Bank, National Association, as administrative agent, and Bank of America, N.A., as syndication agent. The Credit Agreement provided for (a) a secured revolving loan facility in an aggregate principal amount of up to \$300.0 million (the "Revolving Loan Facility"), and (b) a secured term loan facility in an aggregate principal amount of \$300.0 million (the "Term Loan"), which was fully drawn at closing. The Term Loan amortized \$18.8 million per quarter.

On March 15, 2016, the Company entered into a First Amendment to Credit Agreement (the "Amendment to Credit Agreement") with Wells Fargo Bank, National Association, as administrative agent and Bank of America, N.A. The Amendment to Credit Agreement amended certain terms of the Credit Agreement, dated as of December 3, 2014. The Amendment to Credit Agreement provided for (a) an increase in the secured revolving credit commitments by \$50.0 million, bringing the aggregate principal amount of the revolving credit commitments under the Credit Agreement to \$350.0 million, (b) a new secured term loan (the "Incremental Term Loan") in the aggregate principal amount of \$93.8 million having a maturity date of March 15, 2021, and (c) an extension of the termination date of the Revolving Loan Facility and the maturity date of the Term Loan from December 3, 2019 to March 15, 2021. The Amendment to Credit Agreement extended the amortization period for the Term Loan and decreased the quarterly amortization payments for that loan to \$7.5 million per quarter. The Amendment to Credit Agreement additionally reduced the pricing levels under the Credit Agreement to a range of 0.15% to 0.30% in the case of the commitment fee, 1.125% to 2.0% in the case of the applicable margin for LIBOR loans, and 0.125% to 1.0% in the case of the applicable margin for base rate loans, based on the Company's consolidated total net leverage ratio during the preceding fiscal quarter. The Company borrowed the entire \$93.8 million principal amount of the Incremental Term Loan concurrent with the closing of the

Amendment to Credit Agreement.

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On July 21, 2016, the Company entered into a Second Amendment to Credit Agreement (the “Second Amendment to Credit Agreement”) with Wells Fargo Bank, National Association, SunTrust Bank, and Bank of America, N.A., as administrative agent (as successor in interest to Wells Fargo Bank). The Second Amendment to Credit Agreement amends certain terms of the Credit Agreement, dated as of December 3, 2014 as amended by the Amendment to Credit Agreement, dated as of March 15, 2016. The Second Amendment to Credit Agreement provides for, among other things, (a) an increase in the secured revolving credit commitments by \$500.0 million, bringing the aggregate principal amount of the revolving credit commitments under the Credit Agreement to \$850.0 million, (b) the repayment of existing term loans outstanding under the Credit Agreement, (c) an extension of the termination date of the revolving credit facility under the Credit Agreement from March 15, 2021 to July 21, 2021, and (d) increased covenant flexibility.

Concurrent with the closing of the Second Amendment to Credit Agreement, the Company prepaid in full the outstanding \$242.5 million principal amount of the Term Loan and Incremental Term Loan under the Credit Agreement without premium or penalty. The Second Amendment to Credit Agreement reduced the pricing levels under the Credit Agreement to a range of 0.125% to 0.20% in the case of the commitment fee, 1.00% to 1.75% in the case of the applicable margin for LIBOR loans, and 0.0% to 0.75% in the case of the applicable margin for base rate loans, in each case depending on the Company’s consolidated total net leverage ratio. The principal purposes of these financing transactions were to increase the size and availability under the Company’s Revolving Loan Facility and to provide additional long-term financing. The proceeds are being used for general corporate purposes, including working capital and capital expenditures, potential share repurchases, acquisitions, or other investments relating to the Company’s expansion strategies in domestic and international markets.

The Revolving Loan Facility under the Credit Agreement bears interest, at the election of the Company, at either (a) the Base Rate, which is defined as a fluctuating rate per annum equal to the greatest of (i) the Prime Rate in effect on such day; (ii) the Federal Funds Rate in effect on such date plus 0.50%; or (iii) an adjusted LIBOR rate determined on the basis of a one-month interest period plus 1.0%, in each case plus an applicable margin ranging from 0.0% to 0.75% based on the Company’s consolidated total net leverage ratio during the preceding fiscal quarter; or (b) an adjusted LIBOR rate plus an applicable margin ranging from 1.00% to 1.75% depending on the Company’s consolidated total net leverage ratio during the preceding fiscal quarter. Interest is due and payable quarterly, in arrears, for loans bearing interest at the Base Rate, and at the end of an interest period (or at each three month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. The interest rate as of January 31, 2019 on the Company’s Revolving Loan Facility was the one month LIBOR rate of 2.50% plus an applicable margin of 1.00%. The carrying amount of the Credit Agreement is comprised of borrowings under which interest accrues under a fluctuating interest rate structure. Accordingly, the carrying value approximates fair value at January 31, 2019, and was classified within Level II of the fair value hierarchy.

Amounts borrowed under the Revolving Loan Facility may be repaid and reborrowed until the maturity date of July 21, 2021. The Company is obligated to pay a commitment fee on the unused portion of the Revolving Loan Facility. The commitment fee rate ranges from 0.125% to 0.20%, depending on the Company’s consolidated total net leverage ratio during the preceding fiscal quarter, on the average daily unused portion of the revolving credit commitment under the Credit Agreement. The Company had \$93.3 million of outstanding borrowings under the Revolving Loan Facility as of January 31, 2019 and no outstanding borrowings under the Revolving Loan Facility at July 31, 2018. The Company’s obligations under the Credit Agreement are guaranteed by certain of the Company’s domestic subsidiaries meeting materiality thresholds set forth in the Credit Agreement. Such obligations, including the guaranties, are secured by substantially all of the assets of the Company and the assets of the subsidiary guarantors pursuant to a Security Agreement, dated December 3, 2014, among the Company, the subsidiary guarantors from time to time party thereto, and Wells Fargo Bank, National Association, as collateral agent.

The Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries’ ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends, or make distributions on and repurchase stock, in each case subject to certain exceptions. The Company is also required to maintain compliance, measured at the end of each fiscal quarter, with a consolidated total net leverage ratio and a consolidated interest coverage ratio. The Credit Agreement contains no restrictions on the payment of

dividends and other restricted payments, as defined, as long as (1) the consolidated total net leverage ratio, as defined, both before and after giving effect to any such dividend or restricted payment on a pro forma basis, is less than 3.25:1, in an unlimited amount, (2) if clause (1) is not available, so long as the consolidated total net leverage ratio both before and after giving effect to any such dividend on a pro forma basis is less than 3.50:1, in an aggregate amount not to exceed the available amount, as defined, and (3) if clauses (1) and (2) are not available, in an aggregate amount not to exceed \$50.0 million; provided, that, minimum liquidity, as defined, shall be not less than \$75.0 million both before and after giving effect to any such dividend or restricted payment. As of January 31, 2019, the consolidated total net leverage ratio was 0.53:1. Minimum liquidity as of January 31, 2019 was \$0.8 billion. Accordingly, the Company does not believe that the provisions of the Credit Agreement represent a significant restriction to its ability to pay dividends or to the successful future operations of the business. The Company has not paid a cash dividend since becoming a public company in 1994. The Company was in compliance with all covenants related to the Credit Agreement as of January 31, 2019.

### **Note Purchase Agreement**

On December 3, 2014, the Company entered into a Note Purchase Agreement and sold to certain purchasers (collectively, the “Purchasers”) \$400.0 million in aggregate principal amount of senior secured notes (the “Senior Notes”) consisting of (i) \$100.0 million aggregate principal amount of 4.07% Senior Notes, Series A, due December 3, 2024; (ii) \$100.0 million aggregate principal amount of 4.19% Senior Notes, Series B, due December 3, 2026; (iii) \$100.0 million aggregate principal amount of 4.25% Senior Notes, Series C, due December 3, 2027; and (iv) \$100.0 million aggregate principal amount of 4.35% Senior Notes, Series D, due December 3, 2029. Interest is due and payable quarterly, in arrears, on each of the Senior Notes. Proceeds from the Note Purchase Agreement are being used for general corporate purposes.

On July 21, 2016, the Company entered into Amendment No. 1 to Note Purchase Agreement (the “First Amendment to Note Purchase Agreement”) which amended certain terms of the Note Purchase Agreement, including providing for increased flexibility substantially consistent with the changes included in the Second Amendment to Credit Agreement, including among other things increased covenant flexibility.

The Company may prepay the Senior Notes, in whole or in part, at any time, subject to certain conditions, including minimum amounts and payment of a make-whole amount equal to the discounted value of the remaining scheduled interest payments under the Senior Notes.

The Company’s obligations under the Note Purchase Agreement are guaranteed by certain of the Company’s domestic subsidiaries meeting materiality thresholds set forth in the Note Purchase Agreement. Such obligations, including the guaranties, are secured by substantially all of the assets of the Company and assets of the subsidiary guarantors. The obligations of the Company and its subsidiary guarantors under the Note Purchase Agreement will be treated on a *pari passu* basis with the obligations of those entities under the Credit Agreement as well as any additional debt the Company may obtain.

The Note Purchase Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries’ ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends, or make distributions and repurchase stock, in each case subject to certain exceptions. The Company is also required to maintain compliance, measured at the end of each fiscal quarter, with a consolidated total net leverage ratio and a consolidated interest coverage ratio. The Note Purchase Agreement contains no restrictions on the payment of dividends and other restricted payments, as defined, as long as (1) the consolidated total net leverage ratio, as defined, both before and after giving effect to any such dividend or restricted payment on a pro forma basis, is less than 3.25:1, in an unlimited amount, (2) if clause (1) is not available, so long as the consolidated total net leverage ratio both before and after giving effect to any such dividend on a pro forma basis is less than 3.50:1, in an aggregate amount not to exceed the available amount, as defined, and (3) if clauses (1) and (2) are not available, in an aggregate amount not to exceed \$50.0 million; provided, that, minimum liquidity, as defined, shall be not less than \$75.0 million both before and after giving effect to any such dividend or restricted payment. As of January 31, 2019, the consolidated total net leverage ratio was 0.53:1. Minimum liquidity as of January 31, 2019 was \$0.8 billion. Accordingly, the Company does not believe that the provisions of the Note Purchase Agreement represent a significant restriction to its ability to pay dividends or to the successful future operations of the business. The Company has not paid a cash dividend since becoming a public company in 1994. The Company was in compliance with all covenants related to the Note Purchase Agreement as of January 31, 2019.

Related to the execution of the Credit Agreement, First Amendment to Credit Agreement, Second Amendment to Credit Agreement, and the Note Purchase Agreement, the Company incurred \$3.4 million in costs, of which \$2.0 million was capitalized as debt issuance fees and \$1.4 million was recorded as a reduction of the long-term debt proceeds as a debt discount. Both the debt issuance fees and debt discount are amortized to interest expense over the term of the respective debt instruments and are classified as reductions of the outstanding liability.

**NOTE 4 – Goodwill and Intangible Assets**

The following table sets forth amortizable intangible assets by major asset class:

<u>(In thousands)</u>	January 31, 2019	July 31, 2018
Amortized intangibles:		
Supply contracts & customer relationships	\$ 49,206	\$ 71,787
Trade name	23,573	24,173
Licenses and databases	7,706	9,291
Covenants not to compete	—	1,666
Accumulated amortization	(20,220 )	(42,025 )
Net intangibles	\$ 60,265	\$ 64,892

Aggregate amortization expense on amortizable intangible assets was \$2.6 million and \$3.5 million for the three months ended January 31, 2019 and 2018, respectively, and \$5.5 million and \$7.4 million for the six months ended January 31, 2019 and 2018, respectively. During the six months ended January 31, 2019, the Company retired fully amortized intangible assets of \$28.0 million, which were no longer being utilized.

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

Balance as of July 31, 2018	\$ 337,235
Effect of foreign currency exchange rates	810
Balance as of January 31, 2019	\$ 338,045

**NOTE 5 – Fair Value Measures**

The following table summarizes the fair value of the Company's financial assets and liabilities measured and recorded at fair value on a recurring basis based on inputs used to derive their fair values:

<u>(In thousands)</u>	January 31, 2019		July 31, 2018	
	Fair Value Total	Significant Observable Inputs (Level II)	Fair Value Total	Significant Observable Inputs (Level II)
<b>Assets</b>				
Cash equivalents	\$ 12,840	\$ 12,840	\$ 130,769	\$ 130,769
<b>Total Assets</b>	\$ 12,840	\$ 12,840	\$ 130,769	\$ 130,769
<b>Liabilities</b>				
Long-term fixed rate debt, including current portion	\$ 391,961	\$ 391,961	\$ 381,230	\$ 381,320
Revolving loan facility	93,300	93,300	—	—
<b>Total Liabilities</b>	\$ 485,261	\$ 485,261	\$ 381,230	\$ 381,320

During the six months ended January 31, 2019, no transfers were made between any levels within the fair value hierarchy. See *Note 1 – Summary of Significant Accounting Policies*, and *Note 3 – Long-Term Debt*.

**NOTE 6 – Net Income Per Share**

The table below reconciles basic weighted average shares outstanding to diluted weighted average shares outstanding:

<u>(In thousands)</u>	Three Months Ended January 31,		Six Months Ended January 31,	
	2019	2018	2019	2018
Weighted average common shares outstanding	230,798	231,478	232,343	231,086
Effect of dilutive securities - stock options	9,862	9,882	10,400	8,990
Weighted average common and dilutive potential common shares outstanding	240,660	241,360	242,743	240,076



There were no material adjustments to net income required in calculating diluted net income per share. Excluded from the dilutive earnings per share calculation were 425,000 and 2,287,500 options to purchase the Company's common stock for the three months ended January 31, 2019 and 2018, respectively, and 460,000 and 4,478,004 options to purchase the Company's common stock for the six months ended January 31, 2019 and 2018, respectively, because their inclusion would have been anti-dilutive.

#### **NOTE 7 – Stock-based Compensation**

The Company recognizes compensation expense for stock option awards on a straight-line basis over the requisite service period of the award. The following is a summary of activity for the Company's stock options for the six months ended January 31, 2019:

<u>(In thousands, except per share and term data)</u>	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value
Outstanding as of July 31, 2018	17,797	\$ 20.29	6.19	\$660,268
Grants of options	150	47.19		
Exercises	(294 )	17.74		
Forfeitures or expirations	(98 )	26.33		
Outstanding as of January 31, 2019	17,555	\$ 20.53	5.02	\$528,435
Exercisable as of January 31, 2019	14,077	\$ 18.51	4.40	\$452,199

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company's common stock. The number of options that were in-the-money was 17,555,424 at January 31, 2019.

The table below sets forth the stock-based compensation recognized by the Company:

<u>(In thousands)</u>	Three Months Ended January 31,		Six Months Ended January 31,	
	2019	2018	2019	2018
General and administrative	\$4,691	\$4,990	\$9,680	\$9,444
Yard operations	1,238	1,002	2,270	1,854
Total stock-based compensation	\$5,929	\$5,992	\$11,950	\$11,298

In accordance with ASC 718, *Compensation – Stock Compensation*, the Company made an estimate of expected forfeitures and recognized compensation cost only for those equity awards expected to vest.

In October 2013, the Compensation Committee of the Company's Board of Directors, subject to stockholder approval (which was subsequently obtained at the December 16, 2013 annual meeting of stockholders), approved the grant to each of A. Jayson Adair, the Company's Chief Executive Officer, and Vincent W. Mitz, the Company's former President, of nonqualified stock options to purchase 4,000,000 and 3,000,000 shares of the Company's common stock, respectively, at an exercise price of \$17.81 per share, which equaled the closing price of the Company's common stock on December 16, 2013, the effective date of grant. Such grants were made in lieu of any cash salary or bonus compensation in excess of \$1.00 per year or the grant of any additional equity incentives for a five year period. Each option will become exercisable over five years, subject to continued service by Mr. Adair and Mr. Mitz, with 20% vesting on April 15, 2015 and December 16, 2014, respectively, and the balance vesting monthly over the subsequent four years. On December 16, 2018, the option held by Mr. Mitz became fully vested and the option held by Mr. Adair will become fully vested, assuming continued service by Mr. Adair on April 15, 2019. If, prior to a change in control, either executive's employment is terminated without cause, then 100% of the shares subject to that executive's stock option will immediately vest. If, upon or following a change in control, either the Company or a successor entity terminates the executive's service without cause, or the executive resigns for good reason (as defined in the option agreement), then 100% of the shares subject to his stock option will immediately vest. On June 2, 2015, the Compensation Committee of the Company's Board of Directors approved the amendment of each of the stand-alone stock option agreements, by and between the Company and A. Jayson Adair and Vincent W. Mitz, respectively, to remove the provision providing at times prior to a "change in control" for the immediate vesting in full of the underlying

option upon an involuntary termination of Mr. Adair or Mr. Mitz, as applicable, without “cause.” The fair value of each option at the date of grant using the Black-Scholes Merton option-pricing model was \$5.72. The total estimated compensation expense to be recognized by the Company over the five year estimated service period for these options is \$40.0 million. The Company recognized \$3.5 million and \$3.6 million in compensation expenses for these grants in the six months ended January 31, 2019 and 2018, respectively.

**NOTE 8 – Stock Repurchases**

On September 22, 2011, the Company’s Board of Directors approved an 80 million share increase in the stock repurchase program, bringing the total current authorization to 196 million shares. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the stock repurchase program. Subject to applicable securities laws, such repurchases will be made at such times and in such amounts as the Company deems appropriate and may be discontinued at any time. The Company repurchased 7,635,596 shares of its common stock under the program during the six months ended January 31, 2019 at a weighted average price of \$47.81 per share totaling \$365.0 million. The Company did not repurchase any shares of its common stock under the program during the six months ended January 31, 2018. As of January 31, 2019, the total number of shares repurchased under the program was 114,549,198, and 81,450,802 shares were available for repurchase under the program.

In fiscal 2018, certain members of the Company’s Board of Directors exercised stock options through cashless exercises. A portion of the options exercised were net settled in satisfaction of the exercise price. The Company remitted no amounts for the six months ended January 31, 2019 and 2018, respectively, to the proper taxing authorities in satisfaction of the employees’ statutory withholding requirements.

The exercised stock options, utilizing a cashless exercise, are summarized in the following table:

Period	Options Exercised	Weighted Average Exercise Price	Shares Net Settled for Exercise	Shares Withheld for Taxes <sup>(1)</sup>	Net Shares to Individuals	Weighted Average Share Price for Withholding	Employee Stock Based Tax Withholding (in 000s)
FY 2018—Q2	20,000	\$ 6.54	11,996	—	68,004	\$ 43.60	\$ —

<sup>(1)</sup> Shares withheld for taxes are treated as a repurchase of shares for accounting purposes but do not count against the Company’s stock repurchase program.

**NOTE 9 – Income Taxes**

The Company applies the provisions of the accounting standard for uncertain tax positions to its income taxes. For benefits to be realized, a tax position must be more likely than not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

On December 22, 2017 legislation, commonly referred to as the Tax Cuts and Jobs Act (the “Act”), was enacted. The Act included a one-time tax on accumulated unremitted earnings of our foreign subsidiaries (“Transition Tax”). SEC Staff Accounting Bulletin No. 118 allows the use of provisional amounts (reasonable estimates) if accounting for the income tax effects of the Act has not been completed. Provisional amounts must be adjusted within one year from the enactment date of the Act. As of July 31 2018, the Company recorded a \$12.4 million provisional Transition Tax charge. No adjustment to the provisional Transition Tax charge was made in the first quarter of fiscal year 2019. The Company completed its accounting for the tax effects of the enactment of the Tax Act during the three months ended January 31, 2019, and recorded a discrete decrease in tax expense of \$1.1 million, whose effect on the Company’s effective tax rate was immaterial for the three months ended January 31, 2019.

The Act reduced the U.S. federal statutory tax rate from 35.0% to 21.0%, effective January 1, 2018, which resulted in a fiscal year 2018 U.S. federal statutory tax rate of . The Company’s U.S. federal statutory tax rate for fiscal year 2019 is 21.0%.

The Act contains Global Intangible Low-Taxed Income (“GILTI”) provisions, which first impact the Company in fiscal year 2019. The GILTI provisions effectively subject income earned by the Company’s foreign subsidiaries to current U.S. tax at a rate of 10.5%, less foreign tax credits. Under U.S. GAAP the Company can make an accounting policy election to either recognize deferred taxes for temporary differences expected to impact GILTI in future years or provide for tax expense related to GILTI in the year the tax is incurred as a period expense. The Company has elected to treat tax generated by GILTI provisions as a period expense.

The Act also includes a favorable tax treatment for certain Foreign Derived Intangible Income (“FDII”), effective for the Company starting August 1, 2018. The Company’s provisional estimate for both GILTI and FDII did not materially impact the effective income tax rate or income tax expense for the three or six months ended January 31, 2019.

As of January 31, 2019, the gross amounts of the Company’s liabilities for unrecognized tax benefits of \$30.4 million,



including interest and penalties, were classified as long-term income taxes payable in the accompanying consolidated balance sheets. Over the next twelve months, the Company's existing positions will continue to generate an increase in liabilities for unrecognized tax benefits, as well as a likely decrease in liabilities as a result of the lapse of the applicable statute of limitations and the conclusion of income tax audits. The expected decrease in liabilities relating to unrecognized tax benefits will have a positive effect on the Company's consolidated results of operations and financial position when realized. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

The Company files income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions. The Company is currently under examination by certain taxing authorities in the U.S. for fiscal years between 2014 and 2017. At this time, the Company does not believe that the outcome of any examination will have a material impact on the Company's consolidated results of operations and financial position.

The Company's effective income tax rates were 20.4% and 28.5% for the three months ended January 31, 2019 and 2018, respectively, and 21.8% and 30.1% for the six months ended January 31, 2019 and 2018, respectively.

for the three months ended January 31, 2019	21.0%
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The effective tax rates in the current and prior year were also impacted from the result of recognizing excess tax benefits from the exercise of employee stock options of \$4.8 million and \$2.6 million for the three months ended January 31, 2019 and 2018, respectively, and \$5.0 million and \$6.4 million for the six months ended January 31, 2019 and 2018, respectively.

#### **NOTE 10 – Recent Accounting Pronouncements**

##### ***Pending***

In February 2018, the FASB issued ASU 2018-02, *Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The current standard, ASC Topic 740 - *Income Taxes*, requires deferred tax liabilities and assets to be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date. This includes the tax effects of items in accumulated other comprehensive income ("AOCI") that were originally recognized in other comprehensive income, subsequently creating stranded tax effects. ASU 2018-02 allows a reclassification from AOCI to retained earnings for stranded tax effects specifically resulting from the U.S. federal government's recently enacted tax bill, the Tax Cuts and Jobs Act. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those periods. Early adoption is permitted. The adoption of ASU 2018-02 will result in a reclassification from AOCI to retained earnings and will have no impact on the Company's consolidated results of operations, financial position or cash flows.

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350)*. ASU 2017-04 amends the requirement that entities compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, entities should perform their annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment if the carrying amount exceeds the reporting unit's fair value. ASU 2017-04 is effective for annual periods beginning after December 15, 2019. The Company's adoption of ASU 2017-04 will not have a material impact on the Company's consolidated results of operations and financial position.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, that supersedes all existing guidance on accounting for leases in ASC Topic 840. ASU 2016-02 is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. ASU 2016-02 will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of income. ASU 2016-02 is effective for annual and interim periods within those annual reporting periods beginning after December 15, 2018 and adoption is to be applied with a modified retrospective approach to each prior reporting period presented with various optional practical expedients; however early adoption is permitted. Based on a preliminary assessment, the Company expects that most of its operating lease commitments will be subject to the new guidance and recognized as operating lease liabilities and right-of-use assets upon adoption, resulting in a significant increase in the assets and liabilities on the Company's consolidated balance sheets. The Company is continuing its assessment, which may identify additional impacts ASU 2016-02 may have on the Company's consolidated results of operations, financial position, and related disclosures.

##### ***Adopted***

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASC 606), which supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition*. ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from

customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for annual and interim periods within those annual reporting periods beginning after December 15, 2017 and was effective for the Company beginning with the first quarter of fiscal year 2019. ASU 2014-09 allows adoption with either retrospective application to each period presented, or modified retrospective application, with the cumulative effect recognized as of the date of initial application. The Company used the modified retrospective application with the cumulative effect as its transition method.

Upon adoption, service revenue and vehicle sales revenue are recognized at the date the vehicles are sold at auction. This timing of revenue recognition under ASU 2014-09 is consistent with the Company's previous policy under ASC 605 for most service and vehicle sales revenue. However, the adoption represents a change in the timing of revenue recognition for certain service revenues, such as inbound transportation and titling fees, which were previously recognized under ASC 605 when the services were performed, which generally occurred prior to auction. Related costs to prepare the vehicles for auction, including inbound transportation and titling, are deferred and recognized at the time of revenue recognition. This change resulted in a decrease to beginning retained earnings as of August 1, 2018, of \$23.0 million as a result of the initial application of the standard and did not have a material impact to earnings.

On August 1, 2018, the Company adopted ASC 606 using the modified retrospective method for all contracts. Results for reporting periods beginning August 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the Company's historic accounting under Topic 605, *Revenue Recognition*.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory*. ASU 2016-16 requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs and eliminates the exception for an intra-entity transfer of an asset, other than inventory. This ASU is effective for annual and interim periods within those annual periods beginning after December 15, 2017, and is required to be adopted using a modified retrospective approach; however early adoption is permitted. The Company's adoption of ASU 2016-16 did not have a material impact on the Company's consolidated results of operations and financial position.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230)*, which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. ASU 2016-15 is effective for interim and annual reporting periods beginning after December 15, 2017. The guidance is required to be applied on a retrospective basis. The Company's adoption of ASU 2016-15 did not have a material impact on the Company's consolidated results of operations and financial position.

#### **NOTE 11 – Legal Proceedings**

The Company is subject to threats of litigation and is involved in actual litigation and damage claims arising in the ordinary course of business, such as actions related to injuries, property damage, contract disputes, and handling or disposal of vehicles. The material pending legal proceedings to which the Company is a party, or of which any of the Company's property is subject, include the following matters.

On November 1, 2013, the Company filed suit against Sparta Consulting, Inc. (now known as KPIT) in the 44th Judicial District Court of Dallas County, Texas, alleging fraud, fraudulent inducement, and/or promissory fraud, negligent misrepresentation, unfair business practices pursuant to California Business and Professions Code § 17200, breach of contract, declaratory judgment, and attorney's fees. The Company sought compensatory and exemplary damages, disgorgement of amounts paid, attorney's fees, pre- and post-judgment interest, costs of suit, and a judicial declaration of the parties' rights, duties, and obligations under the Implementation Services Agreement dated October 6, 2011. The suit arose out of the Company's September 17, 2013 decision to terminate the Implementation Services Agreement, under which KPIT was to design, implement, and deliver a customized replacement enterprise resource planning system for the Company. On January 2, 2014, KPIT removed this suit to the United States District Court for the Northern District of Texas. On August 11, 2014, the Northern District of Texas transferred the suit to the United States District Court for the Eastern District of California for convenience. On January 8, 2014, KPIT filed suit against the Company in the United States District Court for the Eastern District of California, alleging breach of contract, promissory estoppel, breach of the implied covenant of good faith and fair dealing, account stated, quantum meruit, unjust enrichment, and declaratory relief. KPIT sought compensatory and exemplary damages, prejudgment interest, costs of suit, and a judicial declaration of the parties' rights, duties, and obligations under the Implementation Services Agreement. On June 8, 2016, the Company amended its complaint to include claims that KPIT stole certain intellectual property owned by the Company and acted negligently in its provision of services. The case was tried in April and May 2018. On May 22, 2018, the jury returned a verdict for the Company on its fraud claim against KPIT for \$4.7 million, and on its professional negligence claim against KPIT for \$16.3 million, and the jury found for KPIT on its implied covenant counterclaim against the Company for \$4.9 million.

In a September 10, 2018, post-trial order, the Court reduced the Company's professional negligence award to \$9.1 million, found KPIT liable under California's Unfair Competition Law (UCL) for fraudulent and unfair conduct and held that the Company could recover restitution of \$6.3 million if the Company chooses to forego its fraud and professional negligence damages, found that the Company was not entitled to restitution on its unjust enrichment claim, and awarded KPIT prejudgment interest on its implied covenant counterclaim starting from December 26, 2016. On January 24, 2019, the Court heard argument on the Company's motion for prejudgment interest, and on KPIT's motion for judgment notwithstanding the jury verdict, and for new trial. The Court is expected to issue a written opinion on these motions later this year.

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

***Governmental Proceedings***

The Georgia Department of Revenue, or DOR, conducted a sales and use tax audit of the Company's operations in Georgia for the period from January 1, 2007 through June 30, 2011. As a result of their initial audit, the DOR issued a notice of proposed assessment for uncollected sales taxes in which it asserted that the Company failed to collect and remit sales taxes totaling \$73.8 million, including penalties and interest.

The Company subsequently engaged a Georgia law firm and outside tax advisors to review the conduct of its business operations in Georgia, the notice of proposed assessment, and the DOR's policy position. In particular, the Company's outside legal counsel provided the Company an opinion that the sales for resale to non-U.S. registered resellers should not be subject to Georgia sales and use tax.

It was determined that grounds exist for a substantial reduction in the Official Assessment, on the basis that (i) the transactions and resulting tax at issue were erroneously double-counted by the DOR in the audit sales transaction work papers on which the Assessment was based; and (ii) the Company was ultimately able to provide documentation showing that most of the remaining transactions were sales at wholesale, therefore qualifying for the sale for resale exemption from Georgia Sales and Use Tax. After these reductions, the remaining amount of principal Georgia Sales and Use Tax still in dispute between the parties was \$2.6 million, plus applicable interest. A Consent Order to this effect was entered by the Georgia Tax Tribunal on May 22, 2017. The DOR subsequently filed a Motion for Summary Judgment related to the remaining \$2.6 million in dispute. On November 16, 2018, the Georgia Tax Tribunal denied the DOR's motion for summary judgment with regard to substantially all of the amount at issue.

Following the Court's denial of the DOR's Motion for Summary Judgment, the parties engaged in settlement negotiations, which resulted in a confidential settlement and dismissal of the case.

**NOTE 12 – Segments and Other Geographic Reporting**

The Company's U.S. and International regions are considered two separate operating segments and are disclosed as two reportable segments. The segments represent geographic areas and reflect how the chief operating decision maker allocates resources and measures results, including total revenues, operating income and income before income taxes. Intercompany income (expense) is primarily related to charges for services provided by the U.S. segment.

The following table presents financial information by segment:

<u>(In thousands)</u>	Three Months Ended January 31, 2019			Three Months Ended January 31, 2018		
	United States	International	Total	United States	International	Total
Service revenues	\$362,023	\$ 54,784	\$416,807	\$355,542	\$ 46,412	\$401,954
Vehicle sales	28,049	40,042	68,091	29,593	27,559	57,152
Total service revenues and vehicle sales	390,072	94,826	484,898	385,135	73,971	459,106
Yard operations	181,335	34,125	215,460	189,378	27,806	217,184
Cost of vehicle sales	26,883	34,329	61,212	28,794	21,519	50,313
General and administrative	36,452	7,035	43,487	33,953	6,709	40,662
Operating income	145,402	19,337	164,739	133,010	17,937	150,947
Interest (expense) income, net	(4,674 )	119	(4,555 )	(5,628 )	67	(5,561 )
Other income (expense), net	4,674	108	4,782	(490 )	(458 )	(948 )
Intercompany income (expense)	1,931	(1,931 )	—	1,182	(1,182 )	—
Income before income taxes	147,333	17,633	164,966	128,074	16,364	144,438
Income tax expense	32,799	794	33,593	37,677	3,460	41,137
Net income	\$114,534	\$ 16,839	\$131,373	\$90,397	\$ 12,904	\$103,301

Depreciation and amortization	\$17,877	\$ 2,522	\$20,399	\$14,054	\$ 3,817	\$17,871
Capital expenditures	66,901	7,490	74,391	56,804	12,617	69,421

<u>(In thousands)</u>	Six Months Ended January 31, 2019			Six Months Ended January 31, 2018		
	United States	International	Total	United States	International	Total
Service revenues	\$705,596	\$ 106,017	\$811,613	\$686,933	\$ 89,146	\$776,079
Vehicle sales	55,685	78,968	134,653	49,307	52,888	102,195
Total service revenues and vehicle sales	761,281	184,985	946,266	736,240	142,034	878,274
Yard operations	358,977	64,177	423,154	382,211	52,580	434,791
Cost of vehicle sales	52,826	66,142	118,968	47,554	41,056	88,610
General and administrative	73,784	14,181	87,965	67,446	12,538	79,984
Operating income	275,694	40,485	316,179	239,029	35,860	274,889
Interest (expense) income, net	(8,488 )	242	(8,246 )	(11,116 )	157	(10,959 )
Other income (expense), net	5,299	520	5,819	(4,601 )	(763 )	(5,364 )
Intercompany income (expense)	3,342	(3,342 )	—	3,486	(3,486 )	—
Income before income taxes	275,847	37,905	313,752	226,798	31,768	258,566
Income tax expense	63,265	5,031	68,296	71,262	6,443	77,705
Net income	\$212,582	\$ 32,874	\$245,456	\$155,536	\$ 25,325	\$180,861

Depreciation and amortization	\$37,269	\$ 4,999	\$42,268	\$27,583	\$ 6,190	\$33,773
Capital expenditures	102,154	34,573	136,727	95,709	15,073	110,782

<u>(In thousands)</u>	January 31, 2019			July 31, 2018		
	United States	International	Total	United States	International	Total
Total assets	\$1,848,216	\$ 448,689	\$2,296,905	\$1,856,058	\$ 451,640	\$2,307,698
Goodwill	256,434	81,611	338,045	256,434	80,801	337,235





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

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

### Overview

We are a leading provider of online auctions and vehicle remarketing services with operations in the United States (U.S.), Canada, the United Kingdom (U.K.), Brazil, the Republic of Ireland, Germany, Finland, the United Arab Emirates (U.A.E.), Oman, Bahrain, and Spain.

Our goals are to generate sustainable profits for our stockholders, while also producing environmental and social benefits for the world, by promoting vehicle restoration, repair, and recycling; parts refurbishment and re-use; and facilitating the recovery and resilience of communities affected by severe climate events and other disasters.

We provide vehicle sellers with a full range of services to process and sell vehicles primarily over the internet through our Virtual Bidding Third Generation internet auction-style sales technology, which we refer to as VB3. Vehicle sellers consist primarily of insurance companies, but also include banks, finance companies, charities, fleet operators, dealers and vehicles sourced directly from individual owners. We sell the vehicles principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters and, at certain locations, to the general public. The majority of the vehicles sold on behalf of insurance companies are either damaged vehicles deemed a total loss or not economically repairable by the insurance companies, or are recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. We offer vehicle sellers a full range of services that help expedite each stage of the vehicle sales process, minimize administrative and processing costs, and maximize the ultimate sales price through the online auction process.

In the U.S., Canada, Brazil, the Republic of Ireland, Finland, the U.A.E., Oman, Bahrain, and Spain, we sell vehicles primarily as an agent and derive revenue primarily from auction and auction related sales transaction fees charged for vehicle remarketing services as well as fees for services subsequent to the auction, such as delivery and storage. In the U.K. and Germany, we operate both as an agent and on a principal basis, in some cases purchasing salvage vehicles outright and reselling the vehicles for our own account. In Germany and Spain, we also derive revenue from listing vehicles on behalf of insurance companies and insurance experts to determine the vehicle's residual value and/or to facilitate a sale for the insured.

We monitor and analyze a number of key financial performance indicators in order to manage our business and evaluate our financial and operating performance. Such indicators include:

*Service and Vehicle Sales Revenue:* Our service revenue consists of auction and auction related sales transaction fees charged for vehicle remarketing services. These auction and auction related services may include a combination of vehicle purchasing fees, vehicle listing fees, and vehicle selling fees that can be based on a predetermined percentage of the vehicle sales price, tiered vehicle sales price driven fees, or at a fixed fee based on the sale of each vehicle regardless of the selling price of the vehicle; transportation fees for the cost of transporting the vehicle to or from our facility; title processing and preparation fees; vehicle storage fees; bidding fees; and vehicle loading fees. These fees are recognized as net revenue (not gross vehicle selling price) at the time of auction in the amount of such fees charged. Purchased vehicle revenue includes the gross sales price of the vehicles which we have purchased or are otherwise considered to own. We have certain contracts with insurance companies, primarily in the U.K., in which we act as a principal, purchasing vehicles and reselling them for our own account. We also purchase vehicles in the open market, primarily from individuals, and resell them for our own account.

Our revenue is impacted by several factors, including total loss frequency and the average vehicle auction selling price, as a significant amount of our service revenue is associated in some manner with the ultimate selling price of the vehicle. Vehicle auction selling prices are driven primarily by: (i) changes in commodity prices, particularly the per ton price for crushed car bodies, as we believe this has an impact on the ultimate selling price of vehicles sold for scrap and vehicles sold for dismantling; (ii) used car pricing, which we also believe has an impact on total loss frequency; (iii) the mix of cars sold; and (iv) changes in the U.S. dollar exchange rate to foreign currencies, which we believe has an impact on auction participation by international buyers. We cannot specifically quantify the financial impact that commodity pricing, used car pricing, and product sales mix has on the selling price of vehicles, our service revenues or financial results. Total loss frequency is the percentage of cars involved in accidents that insurance companies salvage rather than repair and is driven by the relationship between repairs costs, used car values, and auction returns. Over the last several years, we believe there has been an increase in overall growth in the salvage market driven by an increase in total loss frequency. The increase in total loss frequency may have been driven by the decline in used car values relative to repair costs, which we believe are generally trending upward. Conversely, increases in used car prices, such as occurred during the most recent recession, may decrease total loss frequency and adversely affect our growth rate. Used car values are determined by many factors, including used car supply, which is tied directly to new car sales, and the average age of cars on the road. The average age of cars on the road continued to increase, growing from 9.6 years in 2002 to 12.1 years in 2018. The factors that can influence repair costs, used car pricing, and auction returns are many and varied and we cannot predict their movements. Accordingly, we cannot predict future trends in total loss frequency.

*Operating Costs and Expenses:* Yard operations expenses consist primarily of operating personnel (which includes yard management, clerical and yard employees), rent, contract vehicle transportation, insurance, fuel, equipment maintenance and repair, and costs of vehicles sold under the purchase contracts. General and administrative expenses consist primarily of executive management, accounting, data processing, sales personnel, human resources, professional fees, research and development, and marketing expenses.

*Other Income and Expense:* Other income primarily includes income from the rental of certain real property, foreign exchange rate gains and losses, and gains and losses from the disposal of assets, which will fluctuate based on the nature of these activities each period. Other expense consists primarily of interest expense on long-term debt. See Notes to Unaudited Consolidated Financial Statements, *Note 3 – Long-Term Debt*.

*Liquidity and Cash Flows:* Our primary source of working capital is cash operating results and debt financing. The primary source of our liquidity is our cash and cash equivalents and Revolving Loan Facility. The primary factors affecting cash operating results are: (i) seasonality; (ii) market wins and losses; (iii) supplier mix; (iv) accident frequency; (v) total loss frequency; (vi) increased volume from our existing suppliers; (vii) commodity pricing; (viii) used car pricing; (ix) foreign currency exchange rates; (x) product mix; (xi) contract mix to the extent applicable; and (xii) our capital expenditures. These factors are further discussed in the Results of Operations and Risk Factors sections of this Quarterly Report on Form 10-Q.

Potential internal sources of additional working capital are the sale of assets or the issuance of shares through option exercises and shares issued under our Employee Stock Purchase Plan. A potential external source of additional working capital is the issuance of additional debt with new lenders and equity. However, we cannot predict if these sources will be available in the future or on commercially acceptable terms.

### Acquisitions and New Operations

As part of our overall expansion strategy of offering integrated services to vehicle sellers, we anticipate acquiring and developing facilities in new regions, as well as the regions currently served by our facilities. We believe that these acquisitions and openings will strengthen our coverage, as we have facilities located in the U.S., Canada, the U.K., Brazil, the Republic of Ireland, Germany, Finland, the U.A.E., Oman, Bahrain, and Spain with the intention of providing national coverage for our sellers. All of these acquisitions have been accounted for using the purchase method of accounting.

The following table sets forth operational facilities that we have opened and began operations from August 1, 2017 through January 31, 2019:

Locations	Date	Geographic Service Area
Andrews, Texas (Midland)	August 2017	United States
Exeter, Rhode Island	October 2017	United States
Lumberton, North Carolina	June 2018	United States
Spartanburg, South Carolina	August 2018	United States
Madison, Wisconsin	September 2018	United States
Harleyville, South Carolina	January 2019	United States
Macon, Georgia	January 2019	United States
Mocksville, North Carolina	January 2019	United States
Antelope, California	January 2019	United States
Nobitz, Thuringia (Leipzig)	April 2018	Germany
Mannheim, Rhineland-Palatinate	October 2018	Germany
Stuttgart, Baden-Württemberg	November 2018	Germany
Hessen, Frankfurt	November 2018	Germany
Schleswig-Holstein (Hamburg)	November 2018	Germany
Furth, Bavaria (Nuremberg)	November 2018	Germany
Massen, Brandenburg (Berlin)	November 2018	Germany
Friesack, Brandenburg (Berlin)	December 2018	Germany
Belfast, Northern Ireland	April 2018	United Kingdom
Curitiba, Paraná	September 2018	Brazil

The following table sets forth operational facilities obtained through business acquisitions from August 1, 2017 through January 31, 2019:

Locations	Date	Geographic Service Area
Espoo, Finland	March 2018	Finland
Pirkkala, Finland	March 2018	Finland
Oulu, Finland	March 2018	Finland
Turku, Finland	March 2018	Finland

The period-to-period comparability of our consolidated operating results and financial position is affected by business acquisitions, new openings, weather and product introductions during such periods.

In addition to growth through business acquisitions, we seek to increase revenues and profitability by, among other things, (i) acquiring and developing additional vehicle storage facilities in key markets; (ii) pursuing national and regional vehicle seller agreements; (iii) increasing our service offerings; and (iv) expanding the application of VB3 into new markets. In addition, we implement our pricing structure and auction procedures, and attempt to introduce cost efficiencies at each of our acquired facilities by implementing our operational procedures, integrating our management information systems, and redeploying personnel, when necessary.

## Results of Operations

The following table shows certain data from our consolidated statements of income expressed as a percentage of total service revenues and vehicle sales for the three and six months ended January 31, 2019 and 2018:

	Three Months Ended January 31, 2019		Six Months Ended January 31, 2018	
Service revenues and vehicle sales:				
Service revenues	86 %	88 %	86 %	88 %
Vehicle sales	14 %	12 %	14 %	12 %
Total service revenues and vehicle sales	100 %	100 %	100 %	100 %
Operating expenses:				
Yard operations	44 %	47 %	45 %	50 %
Cost of vehicle sales	13 %	11 %	13 %	10 %
General and administrative	9 %	9 %	9 %	9 %
Total operating expenses	66 %	67 %	67 %	69 %
Operating income	34 %	33 %	33 %	31 %
Other expense	— %	(1 )%	— %	(2 )%
Income before income taxes	34 %	32 %	33 %	29 %
Income taxes	7 %	9 %	7 %	9 %
Net income	27 %	23 %	26 %	20 %

## Comparison of the Three and Six Months Ended January 31, 2019 and 2018

The following table presents a comparison of service revenues for the three and six months ended January 31, 2019 and 2018:

(In thousands)	Three Months Ended January 31,				Six Months Ended January 31,			
	2019	2018	Change	% Change	2019	2018	Change	% Change
Service revenues								
United States	\$362,023	\$355,542	\$6,481	1.8 %	\$705,596	\$686,933	\$18,663	2.7 %
International	54,784	46,412	8,372	18.0 %	106,017	89,146	16,871	18.9 %
Total service revenues	\$416,807	\$401,954	\$14,853	3.7 %	\$811,613	\$776,079	\$35,534	4.6 %

**Service Revenues.** The increase in service revenues during the three months ended January 31, 2019 of \$14.9 million, or 3.7%, as compared to the same period last year resulted from (i) an increase in International of \$8.4 million and (ii) an increase in the U.S. of \$6.5 million. The growth in the U.S. was driven primarily by (i) increased volume, (ii) an increase in revenue per car due to higher average auction selling prices, which we believe is due to a change in the mix of vehicles sold and higher commodity prices, partially offset by (iii) Hurricane Harvey, as the storm produced an extraordinary volume of flood damaged vehicles. The increase in volume in the U.S. was derived from (i) growth in the number of units sold from new and expanded contracts with insurance companies, (ii) growth from existing suppliers, driven by what we believe was an increase in total loss frequency. Excluding the detrimental impact of \$3.0 million due to changes in foreign currency exchange rates, primarily from the change in the British pound and Brazilian real to U.S. dollar exchange rates, the growth in International of \$11.4 million was driven primarily by increased volume and higher average auction selling prices.

The increase in service revenues during the six months ended January 31, 2019 of \$35.5 million, or 4.6%, as compared to the same period last year resulted from (i) an increase in the U.S. of \$18.7 million and (ii) an increase in International of \$16.9 million. The growth in the U.S. was driven primarily by (i) increased volume, (ii) an increase in revenue per car due to higher average auction selling prices, which we believe is due to a change in the mix of vehicles sold, and higher commodity prices, partially offset by (iii) Hurricane Harvey, as the storm produced an extraordinary volume of flood damaged vehicles. The increase in volume in the U.S. was derived from (i) growth in the number of units sold from new and expanded contracts with insurance companies, (ii) growth from existing suppliers, driven by what we believe was an increase in total loss frequency. Excluding the detrimental impact of \$4.8

million due to changes in foreign currency exchange rates, primarily from the change in the British pound and Brazilian real to U.S. dollar exchange rates, the growth in International of \$21.7 million was driven primarily by increased volume and higher average auction selling prices.

The following table presents a comparison of vehicle sales for the three and six months ended January 31, 2019 and 2018:

<u>(In thousands)</u>	Three Months Ended January 31,				Six Months Ended January 31,			
	2019	2018	Change	% Change	2019	2018	Change	% Change
Vehicle sales								
United States	\$28,049	\$29,593	\$(1,544)	(5.2)%	\$55,685	\$49,307	\$6,378	12.9%
International	40,042	27,559	12,483	45.3%	78,968	52,888	26,080	49.3%
Total vehicle sales	\$68,091	\$57,152	\$10,939	19.1%	\$134,653	\$102,195	\$32,458	31.8%

**Vehicle Sales.** The increase in vehicle sales for the three months ended January 31, 2019 of \$10.9 million, or 19.1%, as compared to the same period last year resulted from (i) an increase in International of \$12.5 million that was partially offset by (ii) a decrease in the U.S. of \$1.5 million. The decrease in the U.S. was primarily the result of decreased volume. Excluding a detrimental impact of \$1.9 million due to changes in foreign currency exchange rates, primarily from the change in the British pound and European Union euro to U.S. dollar exchange rates, the growth in International of \$14.4 million was primarily the result of higher average auction selling prices and an increase in volume.

The increase in vehicle sales for the six months ended January 31, 2019 of \$32.5 million, or 31.8%, as compared to the same period last year resulted from (i) an increase in International of \$26.1 million and (ii) an increase in the U.S. of \$6.4 million. The increase in the U.S. was primarily the result of increased volume and higher average auction selling prices, which we believe was due to a change in the mix of vehicles sold and higher commodity prices. Excluding a detrimental impact of \$2.5 million due to changes in foreign currency exchange rates, primarily from the change in the British pound and European Union euro to U.S. dollar exchange rates, the growth in International of \$28.6 million was primarily the result of higher average auction selling prices and an increase in volume.

The following table presents a comparison of yard operations expenses for the three and six months ended January 31, 2019 and 2018:

<u>(In thousands)</u>	Three Months Ended January 31,				Six Months Ended January 31,			
	2019	2018	Change	% Change	2019	2018	Change	% Change
Yard operations expenses								
United States	\$181,335	\$189,378	\$(8,043)	(4.2)%	\$358,977	\$382,211	\$(23,234)	(6.1)%
International	34,125	27,806	6,319	22.7%	64,177	52,580	11,597	22.1%
Total yard operations expenses	\$215,460	\$217,184	\$(1,724)	(0.8)%	\$423,154	\$434,791	\$(11,637)	(2.7)%

Yard operations expenses,  
excluding depreciation and  
amortization

United States	\$168,645	\$180,899	\$(12,254)	(6.8)%	\$331,324	\$365,141	\$(33,817)	(9.3)%
International	31,976	24,392	7,584	31.1%	59,806	47,221	12,585	26.7%

Yard depreciation and  
amortization

United States	\$12,690	\$8,479	\$4,211	49.7%	\$27,653	\$17,070	\$10,583	62.0%
International	2,149	3,414	(1,265)	(37.1)%	4,371	5,359	(988)	(18.4)%

**Yard Operations Expenses.** The decrease in yard operations expense for the three months ended January 31, 2019 of \$1.7 million, or 0.8%, as compared to the same period last year resulted from (i) a decrease in the U.S. of \$8.0 million, primarily from abnormal Hurricane Harvey cost in the same period last year, partially offset by an increase in the cost to process each car and growth in volume; that was partially offset by (ii) an increase in International of \$6.3 million, primarily from an increase in the cost to process each car, growth in volume, and partially offset by the beneficial impact of \$1.7 million due to changes in foreign currency exchange rates, primarily from the change in the British pound and Brazilian real to U.S. dollar exchange rate. The increase in the cost to process each car in the same period last year in the U.S. relates to the negative impact of abnormal costs of \$26.6 million for temporary storage facilities;

premiums for subhaulers; labor costs incurred from overtime; travel and lodging due to the reassignment of employees; and equipment lease expenses to handle the increased volume associated with Hurricane Harvey, as the storm produced extraordinary volumes of flood damaged vehicles. These costs did not include normal expenses associated with the increased unit volume created by the hurricane, which are deferred until the sale of the units and are recognized as vehicle pooling costs on the balance sheet. Included in yard operations expenses were depreciation and amortization expenses. The increase in yard operations depreciation and amortization expenses resulted primarily from depreciating new and expanded facilities placed into service in the U.S.



The decrease in yard operations expense for the six months ended January 31, 2019 of \$11.6 million, or 2.7%, as compared to the same period last year resulted from (i) a decrease in the U.S. of \$23.2 million, primarily from abnormal Hurricane Harvey cost in the same period last year, partially offset by an increase in the cost to process each car and growth in volume; and partially offset by (ii) an increase in International of \$11.6 million, primarily from an increase in the cost to process each car, growth in volume, and partially offset by the beneficial impact of \$2.7 million due to changes in foreign currency exchange rates, primarily from the change in the British pound and Brazilian real to U.S. dollar exchange rate. The increase in the cost to process each car in the same period last year in the U.S. relates to the negative impact of abnormal costs of \$62.4 million for temporary storage facilities; premiums for subhaulers; labor costs incurred from overtime; travel and lodging due to the reassignment of employees; and equipment lease expenses to handle the increased volume associated with Hurricane Harvey, as the storm produced extraordinary volumes of flood damaged vehicles. These costs did not include normal expenses associated with the increased unit volume created by the hurricane, which are deferred until the sale of the units and are recognized as vehicle pooling costs on the balance sheet. Included in yard operations expenses were depreciation and amortization expenses. The increase in yard operations depreciation and amortization expenses resulted primarily from depreciating new and expanded facilities placed into service in the U.S.

The following table presents a comparison of cost of vehicle sales for the three and six months ended January 31, 2019 and 2018:

<u>(In thousands)</u>	Three Months Ended January 31,				Six Months Ended January 31,			
	2019	2018	Change	% Change	2019	2018	Change	% Change
Cost of vehicle sales								
United States	\$26,883	\$28,794	\$(1,911)	(6.6)%	\$52,826	\$47,554	\$5,272	11.1%
International	34,329	21,519	12,810	59.5%	66,142	41,056	25,086	61.1%
Total cost of vehicle sales	\$61,212	\$50,313	\$10,899	21.7%	\$118,968	\$88,610	\$30,358	34.3%

**Cost of Vehicle Sales.** The increase in cost of vehicle sales for the three months ended January 31, 2019 of \$10.9 million, or 21.7%, as compared to the same period last year resulted from (i) an increase in International of \$12.8 million that was partially offset by (ii) a decrease in the U.S. of \$1.9 million. The decrease in the U.S. was primarily the result of decreased volume. Excluding the beneficial impact of \$1.7 million due to changes in foreign currency exchange rates, primarily from the change in the British pound and European Union euro to U.S. dollar exchange rates, the increase in International of \$14.5 million was primarily the result of higher average purchase prices and an increase in volume.

The increase in cost of vehicle sales for the six months ended January 31, 2019 of \$30.4 million, or 34.3%, as compared to the same period last year resulted from (i) an increase in International of \$25.1 million and (ii) an increase in the U.S. of \$5.3 million. The increase in the U.S. was primarily the result of increased volume and higher average purchase prices, which we believe was due to higher commodity prices and a change in the mix of vehicles sold. Excluding the beneficial impact of \$2.1 million due to changes in foreign currency exchange rates, primarily from the change in the British pound and European Union euro to U.S. dollar exchange rates, the increase in International of \$27.2 million was primarily the result of higher average purchase prices and an increase in volume.

The following table presents a comparison of general and administrative expenses for the three and six months ended January 31, 2019 and 2018:

<u>(In thousands)</u>	Three Months Ended January 31,				Six Months Ended January 31,			
	2019	2018	Change	% Change	2019	2018	Change	% Change
General and administrative expenses								
United States	\$36,452	\$33,953	\$2,499	7.4%	\$73,784	\$67,446	\$6,338	9.4%
International	7,035	6,709	326	4.9%	14,181	12,538	1,643	13.1%
Total general and administrative expenses	\$43,487	\$40,662	\$2,825	6.9%	\$87,965	\$79,984	\$7,981	10.0%

General and administrative expenses,  
excluding depreciation and amortization

United States	\$31,265	\$28,378	\$2,887	10.2%	\$64,168	\$56,933	\$7,235	12.7%
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International	6,662	6,306	356	5.6 %	13,553	11,707	1,846	15.8 %
General and administrative depreciation and amortization								
United States	\$5,187	\$5,575	\$(388 )	(7.0 )%	\$9,616	\$10,513	\$(897 )	(8.5 )%
International	373	403	(30 )	(7.4 )%	628	831	(203 )	(24.4)%

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**General and Administrative Expenses.** The increase in general and administrative expenses for the three months ended January 31, 2019 of \$2.8 million, or 6.9%, as compared to the same period last year resulted from (i) an increase in the U.S. of \$2.5 million and (ii) an increase in International of \$0.3 million. Excluding depreciation and amortization, the increase in the U.S. of \$2.9 million resulted primarily from supporting our continued growth initiatives, as well as certain litigation costs and the increase in International of \$0.4 million resulted primarily from the expansion of our European businesses. The decrease in depreciation and amortization expenses for the three months ended January 31, 2019 as compared to the same period last year resulted primarily from certain technology and intangible assets becoming fully amortized in the U.S.

The increase in general and administrative expenses for the six months ended January 31, 2019 of \$8.0 million, or 10.0%, as compared to the same period last year resulted from (i) an increase in the U.S. of \$6.3 million and (ii) an increase in International of \$1.6 million. Excluding depreciation and amortization, the increase in the U.S. of \$7.2 million resulted primarily from supporting our continued growth initiatives, as well as certain litigation costs and the increase in International of \$1.8 million resulted primarily from the expansion of our European businesses. The decrease in depreciation and amortization expenses for the six months ended January 31, 2019 as compared to the same period last year resulted primarily from certain technology and intangible assets becoming fully amortized in the U.S.

The following table summarizes total other expenses and income taxes for the three and six months ended January 31, 2019 and 2018:

<u>(In thousands)</u>	Three Months Ended January 31,				Six Months Ended January 31,			
	2019	2018	Change	% Change	2019	2018	Change	% Change
Total other income (expense)	227	(6,509)	6,736	103.5 %	(2,427)	(16,323)	13,896	85.1 %
Income taxes	33,593	41,137	(7,544)	(18.3)%	68,296	77,705	(9,409)	(12.1)%

**Other Income (Expense).** The decrease in total other income (expense) for the three months ended January 31, 2019 of \$6.7 million as compared to the same period last year was primarily due to gains on the disposal of certain non-operating assets in the current year, partially offset by a decrease in interest expense of \$0.5 million as a result of the ongoing paydown of our Revolving Loan Facility, and an increase in currency gains, primarily due to the change in the British pound to U.S. dollar exchange rate.

The decrease in total other income (expense) for the six months ended January 31, 2019 of \$13.9 million as compared to the same period last year was primarily due to gains on the disposal of certain non-operating assets in the current year partially offset by losses on the disposal of certain non-operating assets in the prior year, and a decrease in interest expense of \$1.5 million as a result of the ongoing paydown of our Revolving Loan Facility, and an increase in currency gains, primarily due to the change in the British pound to U.S. dollar exchange rate.

**Income Taxes.** Our effective income tax rates were 20.4% and 28.5% for the three months ended January 31, 2019 and 2018, respectively, and 21.8%, and 30.1% for the six months ended January 31, 2019 and 2018, respectively. The effective tax rate for the three months ended January 31, 2019 was calculated based on the 21.0% U.S. federal statutory rate. For the three months ended January 31, 2018, a fiscal year 2018 federal statutory rate of 35.0% was used. The effective tax rates in the current and prior year were also impacted from the result of recognizing excess tax benefits from the exercise of employee stock options of \$4.8 million and \$2.6 million for the three months ended January 31, 2019 and 2018, respectively, and \$5.0 million and \$6.4 million for the six months ended January 31, 2019 and 2018, respectively. See Note 9 – Income Taxes for a detailed discussion of the Act.

## Liquidity and Capital Resources

The following table presents a comparison of key components of our liquidity and capital resources at January 31, 2019 and July 31, 2018 and for the six months ended January 31, 2019 and 2018, respectively, excluding additional funds available to us through our Revolving Loan Facility:

<u>(In thousands)</u>	January 31, 2019	July 31, 2018	Change	% Change
Cash and cash equivalents	\$ 108,174	\$ 274,520	\$(166,346)	(60.6)%
Working capital	256,433	431,860	(175,427)	(40.6)%

  

<u>(In thousands)</u>	Six Months Ended January 31,			
	2019	2018	Change	% Change
Operating cash flows	\$ 215,204	\$ 186,393	\$ 28,811	15.5 %
Investing cash flows	(119,239)	(107,970)	(11,269)	(10.4)%
Financing cash flows	(263,003)	(101,032)	(161,971)	(160.3)%
Capital expenditures	\$(136,727)	\$(110,782)	\$(25,945)	(23.4)%
Net proceeds (repayments) on revolving loan facility	93,300	(120,300)	213,600	177.6 %

Cash and cash equivalents and working capital decreased at January 31, 2019 as compared to July 31, 2018 primarily due to repurchases of our common stock as part of our stock repurchase program and capital expenditures, partially offset by cash generated from operations. Cash equivalents consisted of bank deposits, domestic certificates of deposit, and funds invested in money market accounts, which bear interest at variable rates.

Historically, we have financed our growth through cash generated from operations, public offerings of common stock, equity issued in conjunction with certain acquisitions and debt financing. Our primary source of cash generated by operations is from the collection of service fees and reimbursable advances from the proceeds of vehicle sales. 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 program, we are considering a variety of alternative potential uses for our remaining cash balances and our cash flows from operations. These alternative potential uses include additional stock repurchases, repayments of long-term debt, the payment of dividends, and acquisitions. For further detail, see Notes to Unaudited Consolidated Financial Statements, *Note 3 – Long-Term Debt* and *Note 8 – Stock Repurchases* and under the subheadings “*Credit Agreement*” and “*Note Purchase Agreement*” below.

Our business is seasonal as inclement weather during the winter months increases the frequency of accidents and consequently, the number of cars involved in accidents which the insurance companies salvage rather than repair. During the winter months, most of our facilities process 10% to 30% more vehicles than at other times of the year. This increased volume requires the increased use of our cash to pay out advances and handling costs of the additional business.

We believe that our currently available cash and cash equivalents and cash generated from operations will be sufficient to satisfy our operating and working capital requirements for at least the next 12 months. We expect to acquire or develop additional locations and expand some of our current facilities in the foreseeable future. We may be required to raise additional cash through drawdowns on our Revolving Loan Facility or issuance of additional equity to fund this expansion. Although the timing and magnitude of growth through expansion and acquisitions are not predictable, the opening of new greenfield yards is contingent upon our ability to locate property that (i) is in an area in which we have a need for more capacity; (ii) has adequate size given the capacity needs; (iii) has the appropriate shape and topography for our operations; (iv) is reasonably close to a major road or highway; and (v) most importantly, has the appropriate zoning for our business. Costs to develop a new yard can range from \$3.0 to \$50.0 million, depending on size, location and developmental infrastructure requirements.

As of January 31, 2019, \$69.4 million of the \$108.2 million of cash and cash equivalents was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., the repatriation of these funds could still be subject to the foreign withholding tax following the U.S. Tax Reform. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not require repatriation to fund our U.S. operations. See Notes to Unaudited Consolidated Financial Statements, *Note 9 – Income Taxes* for further discussion regarding U.S. tax reform and its corresponding impact on foreign cash repatriation.

Net cash provided by operating activities increased for the six months ended January 31, 2019 as compared to the same period in 2018 due to improved cash operating results from an increase in service revenues and vehicle sales and changes in operating assets and liabilities. The change in operating assets and liabilities was primarily the result of a decrease in accounts payable and accrued liabilities of \$31.6 million due to the timing of payments, a decrease in inventory and vehicle pooling costs of \$22.8 million partially offset by an increase of income taxes receivable of \$12.7 million related to excess tax benefits from stock option exercises.

Net cash used in investing activities increased for the six months ended January 31, 2019 as compared to the same period in 2018 due primarily to increased capital expenditures partially offset by an increase in proceeds from the sale of property and equipment. Our capital expenditures are primarily related to lease buyouts of certain facilities, acquiring land, opening and improving facilities, capitalized software development costs for new software for internal use and major software enhancements, and acquiring yard equipment. We continue to develop, expand and invest in new and existing facilities and standardize the appearance of existing locations.

Net cash used in financing activities increased for the six months ended January 31, 2019 as compared to the same period in 2018 due primarily to repurchases of common stock as part of our stock repurchase program, as discussed in further detail under the subheading "Stock Repurchases" and a decrease in proceeds from the exercise of stock options offset by an increase in net proceeds from our Revolving Loan Facility. See Notes to Unaudited Consolidated Financial Statements, *Note 3 – Long-Term Debt* and under the subheadings "Credit Agreement", and "Note Purchase Agreement".

#### **Credit Agreement**

On December 3, 2014, we entered into a Credit Agreement (as amended from time to time, the "Credit Amendment") with Wells Fargo Bank, National Association, as administrative agent, and Bank of America, N.A., as syndication agent. The Credit Agreement provided for (a) a secured revolving loan facility in an aggregate principal amount of up to \$300.0 million (the "Revolving Loan Facility"), and (b) a secured term loan facility in an aggregate principal amount of \$300.0 million (the "Term Loan"), which was fully drawn at closing. The Term Loan amortized \$18.8 million per quarter.

On March 15, 2016, we entered into a First Amendment to Credit Agreement (the "Amendment to Credit Agreement") with Wells Fargo Bank, National Association, as administrative agent and Bank of America, N.A. The Amendment to Credit Agreement amended certain terms of the Credit Agreement, dated as of December 3, 2014. The Amendment to Credit Agreement provided for (a) an increase in the secured revolving credit commitments by \$50.0 million, bringing the aggregate principal amount of the revolving credit commitments under the Credit Agreement to \$350.0 million, (b) a new secured term loan (the "Incremental Term Loan") in the aggregate principal amount of \$93.8 million having a maturity date of March 15, 2021, and (c) an extension of the termination date of the Revolving Loan Facility and the maturity date of the Term Loan from December 3, 2019 to March 15, 2021. The Amendment to Credit Agreement extended the amortization period for the Term Loan and decreased the quarterly amortization payments for that loan to \$7.5 million per quarter. The Amendment to Credit Agreement additionally reduced the pricing levels under the Credit Agreement to a range of 0.15% to 0.30% in the case of the commitment fee, 1.125% to 2.0% in the case of the applicable margin for LIBOR loans, and 0.125% to 1.0% in the case of the applicable margin for base rate loans, based on our consolidated total net leverage ratio during the preceding fiscal quarter. We borrowed the entire \$93.8 million principal amount of the Incremental Term Loan concurrent with the closing of the Amendment to Credit Agreement.

On July 21, 2016, we entered into a Second Amendment to Credit Agreement (the "Second Amendment to Credit Agreement") with Wells Fargo Bank, National Association, SunTrust Bank, and Bank of America, N.A., as administrative agent (as successor in interest to Wells Fargo Bank). The Second Amendment to Credit Agreement amends certain terms of the Credit Agreement, dated as of December 3, 2014 as amended by the Amendment to Credit Agreement, dated as of March 15, 2016. The Second Amendment to Credit Agreement provides for, among other things, (a) an increase in the secured revolving credit commitments by \$500.0 million, bringing the aggregate principal amount of the revolving credit commitments under the Credit Agreement to \$850.0 million, (b) the repayment of existing term loans outstanding under the Credit Agreement, (c) an extension of the termination date of the revolving credit facility under the Credit Agreement from March 15, 2021 to July 21, 2021, and (d) increased covenant flexibility.

Concurrent with the closing of the Second Amendment to Credit Agreement, we prepaid in full the outstanding \$242.5 million principal amount of the Term Loan and Incremental Term Loan under the Credit Agreement without premium or penalty. The Second Amendment to Credit Agreement reduced the pricing levels under the Credit Agreement to a range of 0.125% to 0.20% in the case of the commitment fee, 1.00% to 1.75% in the case of the applicable margin for LIBOR loans, and 0.0% to 0.75% in the case of the applicable margin for base rate loans, in each case depending on our consolidated total net leverage ratio. The principal purposes of these financing transactions were to increase the

size and availability under our Revolving Loan Facility and to provide additional long-term financing. The proceeds are being used for general corporate purposes, including working capital and capital expenditures, potential share repurchases, acquisitions, or other investments relating to our expansion strategies in domestic and international markets.

The Revolving Loan Facility under the Credit Agreement bears interest, at our election, at either (a) the Base Rate, which is defined as a fluctuating rate per annum equal to the greatest of (i) the Prime Rate in effect on such day; (ii) the Federal Funds Rate in effect on such date plus 0.50%; or (iii) an adjusted LIBOR rate determined on the basis of a one-month interest period plus 1.0%, in each case plus an applicable margin ranging from 0.0% to 0.75% based on our consolidated total net leverage ratio during the preceding fiscal quarter; or (b) an adjusted LIBOR rate plus an applicable margin ranging from 1.00% to 1.75% depending on our consolidated total net leverage ratio during the preceding fiscal quarter. Interest is due and payable quarterly, in arrears, for loans bearing interest at the Base Rate, and at the end of an interest period (or at each three month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. The interest rate as of January 31, 2019 on our Revolving Loan Facility was the one month LIBOR rate of 2.50% plus an applicable margin of 1.00%. The carrying amount of the Credit Agreement is comprised of borrowings under which interest accrues under a fluctuating interest rate structure. Accordingly, the carrying value approximates fair value at January 31, 2019, and was classified within Level II of the fair value hierarchy.

Amounts borrowed under the Revolving Loan Facility may be repaid and reborrowed until the maturity date of July 21, 2021. We are obligated to pay a commitment fee on the unused portion of the Revolving Loan Facility. The commitment fee rate ranges from 0.125% to 0.20%, depending on our consolidated total net leverage ratio during the preceding fiscal quarter, on the average daily unused portion of the revolving credit commitment under the Credit Agreement. We had \$93.3 million of outstanding borrowings under the Revolving Loan Facility as of January 31, 2019 and no outstanding borrowings under the Revolving Loan Facility at July 31, 2018.

Our obligations under the Credit Agreement are guaranteed by certain of our domestic subsidiaries meeting materiality thresholds set forth in the Credit Agreement. Such obligations, including the guaranties, are secured by substantially all of our assets and the assets of the subsidiary guarantors pursuant to a Security Agreement, dated December 3, 2014, among us, the subsidiary guarantors from time to time party thereto, and Wells Fargo Bank, National Association, as collateral agent.

The Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict us and our subsidiaries' ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends, or make distributions on and repurchase stock, in each case subject to certain exceptions. We are also required to maintain compliance, measured at the end of each fiscal quarter, with a consolidated total net leverage ratio and a consolidated interest coverage ratio. The Credit Agreement contains no restrictions on the payment of dividends and other restricted payments, as defined, as long as (1) the consolidated total net leverage ratio, as defined, both before and after giving effect to any such dividend or restricted payment on a pro forma basis, is less than 3.25:1, in an unlimited amount, (2) if clause (1) is not available, so long as the consolidated total net leverage ratio both before and after giving effect to any such dividend on a pro forma basis is less than 3.50:1, in an aggregate amount not to exceed the available amount, as defined, and (3) if clauses (1) and (2) are not available, in an aggregate amount not to exceed \$50.0 million; provided, that, minimum liquidity, as defined, shall be not less than \$75.0 million both before and after giving effect to any such dividend or restricted payment. As of January 31, 2019, the consolidated total net leverage ratio was 0.53:1. Minimum liquidity as of January 31, 2019 was \$0.8 billion. Accordingly, we do not believe that the provisions of the Credit Agreement represent a significant restriction to our ability to pay dividends or to the successful future operations of the business. We have not paid a cash dividend since becoming a public company in 1994. We were in compliance with all covenants related to the Credit Agreement as of January 31, 2019.

#### **Note Purchase Agreement**

On December 3, 2014, we entered into a Note Purchase Agreement and sold to certain purchasers (collectively, the "Purchasers") \$400.0 million in aggregate principal amount of senior secured notes (the "Senior Notes") consisting of (i) \$100.0 million aggregate principal amount of 4.07% Senior Notes, Series A, due December 3, 2024; (ii) \$100.0 million aggregate principal amount of 4.19% Senior Notes, Series B, due December 3, 2026; (iii) \$100.0 million aggregate principal amount of 4.25% Senior Notes, Series C, due December 3, 2027; and (iv) \$100.0 million aggregate principal amount of 4.35% Senior Notes, Series D, due December 3, 2029. Interest is due and payable quarterly, in arrears, on each of the Senior Notes. Proceeds from the Note Purchase Agreement are being used for general corporate purposes.

On July 21, 2016, we entered into Amendment No. 1 to Note Purchase Agreement (the "First Amendment to Note Purchase Agreement") which amended certain terms of the Note Purchase Agreement, including providing for increased flexibility substantially consistent with the changes included in the Second Amendment to Credit Agreement, including among other things increased covenant flexibility.

We may prepay the Senior Notes, in whole or in part, at any time, subject to certain conditions, including minimum amounts and payment of a make-whole amount equal to the discounted value of the remaining scheduled interest payments under the Senior Notes.

Our obligations under the Note Purchase Agreement are guaranteed by certain of our domestic subsidiaries meeting materiality thresholds set forth in the Note Purchase Agreement. Such obligations, including the guaranties, are secured by substantially all of our assets and the assets of the subsidiary guarantors. Our obligations and our subsidiary guarantors under the Note Purchase Agreement will be treated on a *pari passu* basis with the obligations of those entities under the Credit Agreement as well as any additional debt that we may obtain.



The Note Purchase Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict us and our subsidiaries' ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends, or make distributions and repurchase stock, in each case subject to certain exceptions. We are also required to maintain compliance, measured at the end of each fiscal quarter, with a consolidated total net leverage ratio and a consolidated interest coverage ratio. The Note Purchase Agreement contains no restrictions on the payment of dividends and other restricted payments, as defined, as long as (1) the consolidated total net leverage ratio, as defined, both before and after giving effect to any such dividend or restricted payment on a pro forma basis, is less than 3.25:1, in an unlimited amount, (2) if clause (1) is not available, so long as the consolidated total net leverage ratio both before and after giving effect to any such dividend on a pro forma basis is less than 3.50:1, in an aggregate amount not to exceed the available amount, as defined, and (3) if clauses (1) and (2) are not available, in an aggregate amount not to exceed \$50.0 million; provided, that, minimum liquidity, as defined, shall be not less than \$75.0 million both before and after giving effect to any such dividend or restricted payment. As of January 31, 2019, the consolidated total net leverage ratio was 0.53:1. Minimum liquidity as of January 31, 2019 was \$0.8 billion. Accordingly, we do not

believe that the provisions of the Note Purchase Agreement represent a significant restriction to our ability to pay dividends or to the successful future operations of the business. We have not paid a cash dividend since becoming a public company in 1994. We are in compliance with all covenants related to the Note Purchase Agreement as of January 31, 2019.

Related to the execution of the Credit Agreement, First Amendment to Credit Agreement, Second Amendment to Credit Agreement, and the Note Purchase Agreement, we incurred \$3.4 million in costs, of which \$2.0 million was capitalized as debt issuance fees and \$1.4 million was recorded as a reduction of the long-term debt proceeds as a debt discount. Both the debt issuance fees and debt discount are amortized to interest expense over the term of the respective debt instruments and are classified as reductions of the outstanding liability.

### **Stock Repurchases**

On September 22, 2011, our Board of Directors approved an 80 million share increase in the stock repurchase program, bringing the total current authorization to 196 million shares. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the stock repurchase program. Subject to applicable securities laws, such repurchases will be made at such times and in such amounts as we deem appropriate and may be discontinued at any time. We repurchased 7,635,596 shares of our common stock under the program during the six months ended January 31, 2019 at a weighted average price of \$47.81 per share totaling \$365.0 million. We did not repurchase any shares of our common stock under the program during the six months ended January 31, 2018. As of January 31, 2019, the total number of shares repurchased under the program was 114,549,198, and 81,450,802 shares were available for repurchase under the program.

In fiscal 2018, certain members of the Company's Board of Directors exercised stock options through cashless exercises. A portion of the options exercised were net settled in satisfaction of the exercise price. We remitted no amounts for the six months ended January 31, 2019 and 2018, respectively, to the proper taxing authorities in satisfaction of the employees' statutory withholding requirements.

The exercised stock options, utilizing a cashless exercise, are summarized in the following table:

Period	Options Exercised	Weighted Average Exercise Price	Shares Net Settled for Exercise	Shares Withheld for Taxes <sup>(1)</sup>	Net Shares to Individuals	Weighted Average Share Price for Withholding	Employee Stock Based Tax Withholding (in 000s)
FY 2018—Q2	20,000	\$ 6.54	11,996	—	68,004	\$ 43.60	—

(1) Shares withheld for taxes are treated as a repurchase of shares for accounting purposes but do not count against our stock repurchase program.

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

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including costs related to vehicle pooling costs; income taxes; stock-based compensation; purchase price allocations; and contingencies. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management has discussed the selection of critical accounting policies and estimates with the Audit Committee of the Board of Directors and the Audit Committee has reviewed our disclosure relating to critical accounting policies and estimates in this Quarterly Report on Form 10-Q. There have been no significant changes to the critical accounting policies and estimates from what was disclosed in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018 filed with the SEC on October 1, 2018. Our significant accounting policies are described in the Notes to Unaudited Consolidated Financial Statements, *Note 1 – Summary of Significant Accounting Policies* in this Quarterly Report on Form 10-Q.

### **Recently Issued Accounting Standards**

For a description of the new accounting standards that affect us, refer to the Notes to Unaudited Consolidated Financial Statements, *Note 10 – Recent Accounting Pronouncements*.

**Contractual Obligations and Commitments**

There have been no material changes during the six months ended January 31, 2019 to our contractual obligations disclosed in our “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018, filed with the SEC on October 1, 2018.

**Off-Balance Sheet Arrangements**

As of January 31, 2019, there are no off-balance sheet arrangements pursuant to Item 303(a)(4) of Regulation S-K promulgated under the Securities Exchange Act of 1934, as amended.

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

There have been no material changes to the information required under this Item from what was disclosed in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018, filed with the SEC on October 1, 2018.

**ITEM 4. CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), or Disclosure Controls, as of the end of the period covered by this Quarterly Report on Form 10-Q. This evaluation, or Controls Evaluation, was performed under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO). Disclosure Controls are controls and procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Disclosure Controls include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Our Disclosure Controls include some, but not all, components of our internal control over financial reporting.

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

(b) Changes in Internal Controls

There have not been any changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

**PART II — OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

We are subject to threats of litigation and are involved in actual litigation and damage claims arising in the ordinary course of business, such as actions related to injuries, property damage, contract disputes, and handling or disposal of vehicles. The material pending legal proceedings to which we are party, or of which our property is subject, include the following matters.

On November 1, 2013, we filed suit against Sparta Consulting, Inc. (now known as KPIT) in the 44th Judicial District Court of Dallas County, Texas, alleging fraud, fraudulent inducement, and/or promissory fraud, negligent misrepresentation, unfair business practices pursuant to California Business and Professions Code § 17200, breach of contract, declaratory judgment, and attorney's fees. We sought compensatory and exemplary damages, disgorgement of amounts paid, attorney's fees, pre- and post-judgment interest, costs of suit, and a judicial declaration of the parties' rights, duties, and obligations under the Implementation Services Agreement dated October 6, 2011. The suit arose out of our September 17, 2013 decision to terminate the Implementation Services Agreement, under which KPIT was to design, implement, and deliver a customized replacement enterprise resource planning system for us. On January 2, 2014, KPIT removed this suit to the United States District Court for the Northern District of Texas. On August 11, 2014, the Northern District of Texas transferred the suit to the United States District Court for the Eastern District of California for convenience. On January 8, 2014, KPIT filed suit against us in the United States District Court for the Eastern District of California, alleging breach of contract, promissory estoppel, breach of the implied covenant of good faith and fair dealing, account stated, quantum meruit, unjust enrichment, and declaratory relief. KPIT sought compensatory and exemplary damages, prejudgment interest, costs of suit, and a judicial declaration of the parties' rights, duties, and obligations under the Implementation Services Agreement. On June 8, 2016, we amended our complaint to include claims that KPIT stole certain intellectual property owned by us and acted negligently in its provision of services. The case was tried in April and May 2018. On May 22, 2018, the jury returned a verdict for us on our fraud claim against KPIT for \$4.7 million, and on our professional negligence claim against KPIT for \$16.3 million, and the jury found for KPIT on its implied covenant counterclaim against us for \$4.9 million.

In a September 10, 2018, post-trial order, the Court reduced our professional negligence award to \$9.1 million, found KPIT liable under California's Unfair Competition Law (UCL) for fraudulent and unfair conduct and held that we could recover restitution of \$6.3 million if we choose to forego our fraud and professional negligence damages, found that we were not entitled to restitution on our unjust enrichment claim, and awarded KPIT prejudgment interest on its implied covenant counterclaim starting from December 26, 2016. On January 24, 2019, the Court heard argument on our motion for prejudgment interest, and on KPIT's motion for judgment notwithstanding the jury verdict, and for new trial. The Court is expected to issue a written opinion on these motions later this year.

We have provided 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 consolidated results of operations and cash flows cannot be predicted because any such effect depends on future results of operations and the amount and timing of the resolution of such matters. We believe that any ultimate liability will not have a material effect on our consolidated results of operations, financial position or cash flows. However, the amount of the liabilities associated with these claims, if any, cannot be determined with certainty. We maintain insurance which may or may not provide coverage for claims made against us. There is no assurance that there will be insurance coverage available when and if needed. Additionally, the insurance that we carry requires that we pay for costs and/or claims exposure up to the amount of the insurance deductibles negotiated when the insurance is purchased.

***Governmental Proceedings***

The Georgia Department of Revenue, or DOR, conducted a sales and use tax audit of our operations in Georgia for the period from January 1, 2007 through June 30, 2011. As a result of their initial audit, the DOR issued a notice of proposed assessment for uncollected sales taxes in which it asserted that we failed to collect and remit sales taxes totaling \$73.8 million, including penalties and interest.

We subsequently engaged a Georgia law firm and outside tax advisors to review the conduct of our business operations in Georgia, the notice of proposed assessment, and the DOR's policy position. In particular, our outside legal counsel provided us with an opinion that the sales for resale to non-U.S. registered resellers should not be subject to Georgia sales and use tax.

It was determined that grounds exist for a substantial reduction in the Official Assessment, on the basis that (i) the transactions and resulting tax at issue were erroneously double-counted by the DOR in the audit sales transaction work papers on which the Assessment was based; and (ii) we were ultimately able to provide documentation showing that most of the remaining transactions were sales at wholesale, therefore qualifying for the sale for resale exemption from Georgia Sales and Use Tax. After these reductions, the remaining amount of principal Georgia Sales and Use Tax still in dispute between the parties was \$2.6 million, plus applicable interest. A Consent Order to this effect was entered by the Georgia Tax Tribunal on May 22, 2017. The DOR subsequently filed a Motion for Summary Judgment related to the remaining \$2.6 million in dispute. On November 16, 2018, the Georgia Tax Tribunal denied the DOR's motion for summary judgment with regard to substantially all of the amount at issue.

Following the Court's denial of the DOR's Motion for Summary Judgment, the parties engaged in settlement negotiations, which resulted in a confidential settlement and dismissal of the case.

## ITEM 1A. RISK FACTORS

Set forth below and elsewhere in this Quarterly Report on Form 10-Q and in other documents we file with the SEC are descriptions of the risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this report. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in “Part I, Item 1A, Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended July 31, 2018.

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

No single customer accounted for more than 10% of our consolidated revenue during the six months ended January 31, 2019. Historically, a limited number of vehicle sellers have collectively accounted for a substantial portion of our revenues. Vehicle sellers have terminated agreements with us in the past in particular markets, which has affected revenues in those markets. There can be no assurance that our existing agreements will not be canceled. Furthermore, there can be no assurance that we will be able to enter into future agreements with vehicle sellers or that we will be able to retain our existing supply of salvage vehicles. A reduction in vehicles from a significant vehicle seller or any material changes in the terms of an arrangement with a significant vehicle seller could have a material adverse effect on our consolidated results of operations and financial position. In addition, a failure to increase our sources of vehicle supply could adversely affect our earnings and revenue growth rates.

**Our expansion into markets outside the U.S., including expansions in Europe, Brazil, and the Middle East expose us to risks arising from operating in international markets. Any failure to successfully integrate businesses acquired or operational capabilities established outside the U.S. could have an adverse effect on our consolidated results of operations, financial position or cash flows.**

We first expanded our operations outside the U.S. in fiscal 2003 with an acquisition in Canada. Subsequently, in fiscal 2008 we made a significant acquisition in the U.K., followed by acquisitions in the U.A.E., Brazil, Germany, and Spain in fiscal 2013, expansions into Bahrain and Oman in fiscal 2015, expansion into the Republic of Ireland and India in fiscal 2016, and an acquisition in Finland in fiscal 2018. In addition, we continue to evaluate acquisitions and other opportunities outside of the U.S. Acquisitions or other strategies to expand our operations outside of the U.S. pose substantial risks and uncertainties that could have an adverse effect on our future operating results. In particular, we may not be successful in realizing anticipated synergies from these acquisitions, or we may experience unanticipated costs or expenses integrating the acquired operations into our existing business. We have and may continue to incur substantial expenses establishing new yards and operations, acquiring buyers and sellers, and implementing shared services capabilities in international markets. Among other things, we plan to ultimately deploy our proprietary auction technologies at all of our foreign operations and we cannot predict whether this deployment will be successful or will result in increases in the revenues or operating efficiencies of any acquired companies relative to their historic operating performance. Integration of our respective operations, including information technology and financial and administrative functions, may not proceed as anticipated and could result in unanticipated costs or expenses such as capital expenditures that could have an adverse effect on our future operating results. We cannot provide any assurance that we will achieve our business and financial objectives in connection with these acquisitions or our strategic decision to expand our operations internationally. For example, although we continue to operate a technology and operations center in India for administrative support, we recently decided to suspend our salvage operations in India, which did not have a material effect on our consolidated results of operations and financial position, until the Indian market develops in a manner better suited to our business model.

As we continue to expand our business internationally, we will need to develop policies and procedures to manage our business on a global scale. Operationally, acquired businesses typically depend on key seller relationships, and our failure to maintain those relationships would have an adverse effect on our consolidated results of operations and could have an adverse effect on our future operating results. Moreover, success in opening and operating facilities in new markets can be dependent upon establishing new relationships with buyers and sellers, and our failure to establish those relationships could have an adverse effect on our consolidated results of operations and future operating results. In addition, we anticipate our international operations will continue to subject us to a variety of risks associated with operating on an international basis, including:

the difficulty of managing and staffing foreign offices;

- the increased travel, infrastructure and legal compliance costs associated with multiple international locations;

the need to localize our product offerings, particularly the need to implement our online auction platform in foreign countries;

the need to comply with complex foreign and U.S. laws and regulations that apply to our international operations; tariffs and trade barriers and other regulatory or contractual limitations on our ability to operate in certain foreign markets;

exposure to foreign currency exchange rate risk, which may have an adverse impact on our revenues and revenue growth rates;



adapting to different business cultures and market structures, particularly where we seek to implement our auction model in markets where insurers have historically not played a substantial role in the disposition of salvage vehicles; and

- repatriation of funds currently held in foreign jurisdictions to the U.S. may result in higher effective tax rates.

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

On June 23, 2016, the U.K. held a referendum in which voters approved an exit from the European Union, commonly referred to as “Brexit.” In February 2017, the British Parliament voted in favor of allowing the British government to begin negotiating the terms of the U.K.’s withdrawal from the European Union and discussions with the European Union began in March 2017. The ultimate effects of Brexit on us are difficult to predict, but adverse consequences concerning Brexit or the European Union could include deterioration in global economic conditions, instability in global financial markets, political uncertainty, volatility in currency exchange rates, or adverse changes in the cross-border agreements currently in place, any of which could have an adverse impact on our financial results in the future. The ultimate effects of Brexit on us will also depend on the terms of agreements, if any, that the U.K. and the European Union make to retain access to each other’s respective markets either during a transitional period or more permanently.

In addition, certain acquisitions in the U.K. may be reviewed by the Competition and Markets Authority (U.K. Regulator). If an inquiry is made by the U.K. Regulator, we may be required to demonstrate that our acquisitions will not result, or be expected to result, in a substantial lessening of competition in the U.K. market. Although we believe that there will not be a substantial lessening of competition in the U.K. market, based on our analysis of the relevant U.K. markets, there can be no assurance that the U.K. Regulator will agree with us if it decides to make an inquiry. If the U.K. Regulator determines that by our acquisitions of certain assets, there is or likely will be a substantial lessening of competition in the U.K. market, we could be required to divest some portion of our U.K. assets. In the event of a divestiture order by the U.K. Regulator, the assets disposed may be sold for substantially less than their carrying value. Accordingly, any divestiture could have a material adverse effect on our operating results in the period of the divestiture.

**Our operations and acquisitions in certain foreign areas expose us to political, regulatory, economic, and reputational risks.**

Although we have implemented policies, procedures and training designed to ensure compliance with anti-bribery laws, trade controls and economic sanctions, and similar regulations, our employees or agents may take actions in violation of our policies. We may incur costs or other penalties in the event that any such violations occur, which could have an adverse effect on our business and reputation.

In some cases, the enforcement practices of governmental regulators in certain foreign areas and the procedural and substantive rights and remedies available to us may vary significantly from those in the United States, which could have an adverse effect on our business.

Although we face risks associated with international expansion in each of the non-U.S. markets where we operate, our current focus on the German market heightens the risks we face relating to our expansion plans in Germany.

In addition, some of our recent acquisitions have required us to integrate non-U.S. companies which had not, until our acquisition, been subject to U.S. law. In many countries outside of the United States, particularly in those with developing economies, it may be common for persons to engage in business practices prohibited by laws and regulations applicable to us, such as the U.S. Foreign Corrupt Practices Act (FCPA), U.K. Bribery Act, Brazil Clean Companies Act, India’s Prevention of Corruption Act, 1988 or similar local anti-bribery laws. These laws generally prohibit companies and their employees or agents from making improper payments for the purpose of obtaining or retaining business. Failure by us and our subsidiaries to comply with these laws could subject us to civil and criminal penalties that could have a material adverse effect on our consolidated operating results and financial position.

**We face risks associated with the implementation of our salvage auction model in markets that may not operate on the same terms as the U.S. market. For example, certain markets operate on a principal rather than agent basis, which may have an adverse impact on our gross margin percentages and expose us to inventory risks that we do not experience in the U.S.**

Some of our target markets outside the U.S. operate in a manner substantially different than our historic market in the U.S. For example, new markets may operate either wholly or partially on the principal model, in which the vehicle is purchased then resold for our own account, rather than the agency model employed in the U.S., in which we generally act as a sales agent for the legal owner of vehicles. Further, operating on a principal basis exposes us to inventory risks, including losses from theft, damage, and obsolescence. In addition, our business in the U.S., Canada, and the U.K. has been established and grown based largely on our ability to build relationships with insurance carriers. In other markets, including Germany, insurers have traditionally been less involved in the disposition of salvage vehicles. As we expand into markets outside the U.S., Canada, and the U.K., including Germany in particular, we cannot predict whether markets will readily adapt to our strategy of online auctions of automobiles sourced principally through vehicle insurers. Any failure of new markets to adopt our business model could adversely affect our consolidated results of operations and financial position.

Acquisitions typically will increase our sales and profitability although, given the typical size of our acquisitions to date, most acquisitions will not individually have a material impact on our consolidated results of operations and financial position. We may not always be able to introduce our processes and selling platform to acquired companies due to different operating models in international jurisdictions or other facts. As a result, the associated benefits of acquisitions may be delayed for years in some international situations. During this period, the acquisitions may operate at a loss and certain acquisitions, while profitable, may operate at a margin percentage that is below our overall operating margin percentage and, accordingly, have an adverse impact on our consolidated results of operations and financial position. Hence, the conversion periods vary from weeks to years and cannot be predicted. **We have developed a proprietary enterprise operating system, and we may experience difficulties operating our business as we continue to design and develop this system.**

We have developed a proprietary enterprise operating system to address our international expansion needs. The ongoing design, development, and implementation of our enterprise operating systems carry certain risks, including the risk of significant design or deployment errors causing disruptions, delays or deficiencies, which may make our website and services unavailable. This type of interruption could prevent us from processing vehicles for our sellers and may prevent us from selling vehicles through our internet bidding platform, VB3, which would adversely affect our consolidated results of operations and financial position. In addition, the transition to our internally developed proprietary system will continue to require us to commit substantial financial, operational and technical resources before the volume of business increases, without assurance that the volume of business will increase. We began using our internally developed proprietary system with our expansion into Spain in fiscal 2016 and Germany in fiscal 2017. We may also implement additional or enhanced information systems in the future to accommodate our growth and to provide additional capabilities and functionality. The implementation of new systems and enhancements is frequently disruptive to the underlying business of an enterprise and can be time-consuming and expensive, increase management responsibilities and divert management attention. Any disruptions relating to our system enhancements or any problems with the implementation, particularly any disruptions impacting our operations or our ability to accurately report our financial performance on a timely basis during the implementation period, could materially and adversely affect our business. Even if we do not encounter these material and adverse effects, the implementation of these enhancements may be much more costly than we anticipated. If we are unable to successfully implement the information systems enhancements as planned, our financial position, results of operations and cash flows could be negatively impacted.

Our success depends on maintaining the integrity of our systems and infrastructure. As our operations continue to grow in both size and scope, domestically and internationally, we must continue to provide reliable, real-time access to our systems by our customers through improving and upgrading our systems and infrastructure for enhanced products, services, features and functionality. Any failure to maintain the integrity of our systems and infrastructure may result in loss of customers due to among other things, slow delivery times, unreliable service levels or insufficient capacity, which could have a material adverse effect on our business, consolidated financial position and results of operations.

**The impairment of internally developed capitalized software costs could adversely affect our consolidated results of operations and financial condition.**

We capitalize certain costs associated with the development of new software products, new software for internal use and major software enhancements to existing software. These costs are amortized over the estimated useful life of the software beginning with its introduction or roll-out. If, at any time, it is determined that capitalized software provides a reduced economic benefit, the unamortized portion of the capitalized development costs will be expensed, in part or in full, as an impairment, which may have a material impact on our consolidated results of operations and financial position. For example, during fiscal 2017, we recognized a \$19.4 million charge primarily related to fully impairing costs previously capitalized in connection with the development of business operating software.

**Disruptions to our information technology systems, including failure to prevent outages, maintain security, prevent unauthorized access to our information technology systems and other confidential information, could disrupt our business and materially and adversely affect our reputation, consolidated results of operations and financial condition.**

Information availability and security risks for online commerce companies have significantly increased in recent years because of, in addition to other factors, the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, and other external parties. These threats may derive from fraud or malice on the part of third parties or current or former employees. In addition, human error or accidental technological failure could make us vulnerable to information technology system disruptions and/or cyber-attacks, including the introduction of malicious computer viruses or code into our system, phishing attacks, or other information technology data security incidents.

Our operations rely on the secure processing, transmission and storage of confidential, proprietary and other information in our computer systems and networks. Our customers and other parties in the payments value chain rely on our digital technologies, computer and email systems, software and networks to conduct their operations. In addition, to access our products and services, our customers increasingly use personal smartphones, tablet PCs and other mobile devices that may be beyond our control.

Information technology system disruptions, cyber-attacks or other cyber security incidents could materially and adversely affect our reputation, operating results, or financial condition by, among other things, making our auction platform inoperable for a period of time, damaging our reputation with buyers, sellers, and insurance companies as a result of the unauthorized disclosure of confidential information (including account data information), or resulting in governmental investigations, litigation, liability, fines, or penalties against us. If such attacks are not detected immediately, their effect could be compounded. While we maintain insurance coverage that may, subject to policy terms and conditions, cover certain aspects of these cyber risks, our insurance coverage may be insufficient to cover all losses and would not remedy damage to our reputation.

We have in the past identified attempts by unauthorized third parties to access our systems and disrupt our online auctions. These attempts have caused minor service interruptions, which were promptly addressed and resolved, and our online service was restored to normal business. For example, in April 2015, we identified that unauthorized third parties had gained access to data provided to us by our members that is considered to be personal information in certain jurisdictions. We immediately investigated, including the engagement of an external expert security firm, and made the required notifications to members whose information may have been accessed and to regulatory agencies. We are constantly evaluating and implementing new technologies and processes to manage risks relating to cyber-attacks and system and network disruptions, including but not limited to usage errors by our employees, power outages and catastrophic events such as fires, tornadoes, floods, hurricanes and earthquakes. We have further enhanced our security protocols based on the investigation we conducted in response to the security incident. Nevertheless, we cannot provide assurances that our efforts to address prior data security incidents and mitigate against the risk of future data security incidents or system failures will be successful. The techniques used by criminals to obtain unauthorized access to sensitive data change frequently and are often not recognized immediately. We may be unable to anticipate these techniques or implement adequate preventative measures and believe that cyber-attacks and threats against us have occurred in the past and are likely to continue in the future. If our systems are compromised again in the future, become inoperable for extended periods of time, or cease to function properly, we may have to make a significant investment to fix or replace them, and our ability to provide many of our electronic and online solutions to our customers may be impaired. In addition, as cyber-threats continue to evolve, we may be required to expend significant additional resources to continue to modify or enhance our protective measures or to investigate and remediate any information security vulnerabilities. Any of the risks described above could materially and adversely affect our consolidated financial position and results of operations.

**Our business is exposed to risks associated with online commerce security and credit card fraud.**

Consumer concerns over the security of transactions conducted on the internet or the privacy of users may inhibit the growth of the internet and online commerce. To securely transmit confidential information such as customer credit card numbers, we rely on encryption and authentication technology. Unanticipated events or developments could result in a compromise or breach of the systems we use to protect customer transaction data. Furthermore, our servers may also be vulnerable to viruses transmitted via the internet and other points of access. While we proactively check for intrusions into our infrastructure, a new or undetected virus could cause a service disruption.

We maintain an information security program and our processing systems incorporate multiple levels of protection in order to address or otherwise mitigate these risks. Despite these mitigation efforts, there can be no assurance that we will be immune to these risks and not suffer losses in the future. Under current credit card practices, we may be held liable for fraudulent credit card transactions and other payment disputes with customers. As such, we have implemented certain anti-fraud measures, including credit card verification procedures. However, a failure to adequately prevent fraudulent credit card transactions could adversely affect our consolidated financial position and results of operations.

Our security measures may also be breached due to employee error, malfeasance, insufficiency, or defective design. Additionally, outside parties may attempt to fraudulently induce employees, users, or customers to disclose sensitive information in order to gain access to our data or our users' or customers' data. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and a loss of confidence in the security of our products and services that could have an adverse effect on our consolidated financial position and results of operations.



**Our business is subject to a variety of domestic and international laws and other obligations regarding privacy and data protection.**

We are subject to federal, state and international laws, directives, and regulations relating to the collection, use, retention, disclosure, security and transfer of personal data. These laws, directives, and regulations, and their interpretation and enforcement continue to evolve and may be inconsistent from jurisdiction to jurisdiction. Recent regulatory changes in Europe have created compliance uncertainty regarding certain transfers of personal data from Europe to the United States. For example, the General Data Protection Regulation (“GDPR”), which went into effect in the European Union (“EU”) on May 25, 2018, applies to all of our activities conducted from an establishment in the EU and may also apply to related products and services that we offer to EU users. Similarly, the California Consumer Privacy Act, or AB375 (“CCPA”), was also recently passed and creates new data privacy rights for users, effective in 2020. Complying with the GDPR, the CCPA, and similar emerging and changing privacy and data protection requirements may cause us to incur substantial costs or require us to change our business practices. Noncompliance with our legal obligations relating to privacy and data protection could result in penalties, legal proceedings by governmental entities or others, and significant legal and financial exposure and could affect our ability to retain and attract customers. Any of the risks described above could adversely affect our consolidated financial position and results of operations.

**Implementation of our online auction model in new markets may not result in the same synergies and benefits that we achieved when we implemented the model in the U.S., Canada, and the U.K.**

We believe that the implementation of our proprietary auction technologies across our operations over the last decade had a favorable impact on our results of operations by increasing the size and geographic scope of our buyer base, increasing the average selling price for vehicles sold through our sales, and lowering expenses associated with vehicle sales.

We implemented our online system across all of our U.S., Canada, and U.K. salvage yards beginning in fiscal 2004 and 2008, respectively, and experienced increases in revenues and average selling prices, as well as improved operating efficiencies in those markets. In considering new markets, we consider the potential synergies from the implementation of our model based in large part on our experience in the U.S., Canada, and the U.K. However, we cannot predict whether these synergies will also be realized in new markets.

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

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

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

We seek to increase our sales and profitability through the acquisition of additional facilities and the development of new facilities. For example, in fiscal 2018, we opened new operational facilities in Andrews, Texas (Midland), Exeter, Rhode Island, and Lumberton, North Carolina, a new operational facility in Belfast, Northern Ireland, a new operational facility in Nobitz, Germany (Leipzig), and acquired locations in the municipalities of Espoo; Pirkkala; Oulu; and Turku, Finland. In fiscal 2019, we opened new operational facilities in Curitiba, Brazil and in Mannheim, Germany and three new operational facilities in Spartanburg, South Carolina, Madison, Wisconsin and Harleyville, South Carolina. Acquisitions are difficult to identify and complete for a number of reasons, including competition

among prospective buyers, the availability of affordable financing in the capital markets and the need to satisfy applicable closing conditions and obtain antitrust and other regulatory approvals on acceptable terms. 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;
- obtain or retain buyers, sellers, and sales volumes in new markets or facilities;
- 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;
- create new vehicle storage facilities that meet our current revenue and profitability requirements; or



- obtain necessary regulatory approvals under applicable antitrust and competition laws.

In addition, certain of the acquisition agreements by which we have acquired companies require the former owners to indemnify us against certain liabilities related to the operation of the company before we acquired it. In most of these agreements, however, the liability of the former owners is limited and certain former owners may be unable to meet their indemnification responsibilities. We cannot assure that these indemnification provisions will protect us fully or at all, and as a result we may face unexpected liabilities that adversely affect our financial statements. Any failure to continue to successfully identify and complete acquisitions and develop new facilities could have a material adverse effect on our consolidated results of operations and financial position.

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

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

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

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

**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;
- fluctuations in commodity prices, particularly the per ton price of crushed car bodies;
- the impact of foreign exchange gain and loss as a result of international operations;
- our ability to successfully integrate our newly acquired operations in international markets and any additional markets we may enter;
- the availability of salvage vehicles or other vehicles we sell;
- variations in vehicle accident rates;
- member participation in the internet bidding process;
- delays or changes in state title processing;
- changes in international, state or federal laws, regulations, or treaties affecting the vehicles we sell;
- changes in the application, interpretation, and enforcement of existing laws, regulations or treaties;
- trade disputes and other political, diplomatic, legal, or regulatory developments;
- inconsistent application or enforcement of laws or regulations by regulators, governmental or quasi-governmental entities, or law enforcement or quasi-law enforcement agencies, as compared to our competitors
- changes in laws affecting who may purchase the vehicles we sell;
- 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;
- the 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;
- 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 or maintain necessary permits to operate.

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 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 position, or results of operations.**

Our intellectual property rights include patents relating to our auction technologies, as well as trademarks, trade secrets, copyrights and other intellectual property rights. In addition, we may enter into agreements with third parties regarding the license or other use of our intellectual property. 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 consolidated results of operations and financial position.

We also may not be able to acquire or maintain appropriate domain names in all countries in which we do business. Furthermore, regulations governing domain names may not protect our trademarks and similar proprietary rights. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon, or diminish the value of our trademarks and other proprietary rights.

**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 auction-style sales technologies across our business and ceased conducting live auctions. Recent U.S. Supreme Court precedent potentially restricts patentability of software inventions by affirming that patent claims merely requiring application of an abstract idea on standard computers utilizing generic computer functions are patent ineligible, which may impact our ability to enforce our issued patent and obtain new patents. As we face increasing competition, the possibility of intellectual property rights claims against us increases. 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.

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

We rely primarily upon independent subhauleders to pick up and deliver vehicles to and from our storage facilities in the U.S., Canada, Brazil, the Republic of Ireland, Germany, Finland, the U.A.E., Oman, Bahrain, and Spain. We also utilize, to a lesser extent, independent subhauleders in the U.K. 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 subhauleders, which may significantly increase our cost. We may not be able to pass these costs on to our sellers or buyers.

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

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

We are partially self-insured for certain losses related to our different lines of insurance coverage including, without limitation, 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. Further, we utilize independent actuaries to assist us in establishing the proper amount of reserves for anticipated payouts associated with these self-insured exposures. 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.

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

Our executive officers, directors and their affiliates beneficially own, in the aggregate, 15.6% of our common stock as of January 31, 2019. If they were to act together, these stockholders would have significant influence over most matters requiring approval by stockholders, including the election of directors, any amendments to our certificate of incorporation and certain significant corporate transactions, including potential merger or acquisition transactions. In addition, without the consent of these stockholders, we could be delayed or prevented from entering into transactions that could be beneficial to us or our other investors. These stockholders may take these actions even if they are opposed by our other investors.

**We have certain provisions in our certificate of incorporation and bylaws which may have an anti-takeover effect or that may delay, defer or prevent acquisition bids for us that a stockholder might consider favorable and limit attempts by our stockholders to replace or remove our current management.**

Our board of directors is authorized to create and issue from time to time, without stockholder approval, up to an aggregate of 5,000,000 shares of undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval, and which may include rights superior to the rights of the holders of common stock. In addition, our bylaws establish advance notice requirements for nominations for elections to our board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings. These anti-takeover provisions and other provisions under Delaware law could discourage, delay or prevent a transaction involving a change in control of our company, even if doing so would benefit our stockholders. These provisions could also discourage proxy contests and make it more difficult for stockholders to elect directors of their choosing and cause us to take other corporate actions the stockholders desire.

**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 Chairman, or A. Jayson Adair, our Chief Executive Officer, or if one or more of these executives decide 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.

**Cash investments are subject to risks.**

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

**Rapid technological changes may render our technology obsolete or decrease the competitiveness of our services.**

To remain competitive, we must continue to enhance and improve the functionality and features of our websites and software. The internet and the online commerce industry are rapidly changing. In particular, the online commerce

industry is characterized by increasingly complex systems and infrastructures. If competitors introduce new services embodying new technologies or if new industry standards and practices emerge, our existing websites and proprietary technology and systems may become obsolete. Our future success will depend on our ability to:

- enhance our existing services;
- develop and license new services and technologies that address the increasingly sophisticated and varied needs of our current and prospective customers; and
- respond to technological advances and emerging industry standards and practices in a cost-effective and timely basis.

Developing our websites and other proprietary technology entails significant technical and business risks. We may use new technologies ineffectively or we may fail to adapt our websites, transaction-processing systems and network infrastructure to customer requirements or emerging industry standards. If we face material delays in introducing new services, products and enhancements, our customers and suppliers may forego the use of our services and use those of our competitors.

**New member programs could impact our operating results.**

We have or will initiate programs to open our auctions to the general public. These programs include the Registered Broker program through which the public can purchase vehicles through a registered member and the Market Maker program through which registered members can open Copart storefronts with internet kiosks enabling the general public to search our inventory and purchase vehicles. Initiating programs that allow access to our online auctions to the general public will involve material expenditures and we cannot predict what future benefit, if any, will be derived.

**Factors such as mild weather conditions can have an adverse effect on our revenues and operating results, as well as our revenue and earnings growth rates, by reducing the available supply of salvage vehicles.**

**Conversely, extreme weather conditions can result in an oversupply of salvage vehicles that requires us to incur abnormal expenses to respond to market demands.**

Mild weather conditions tend to result in a decrease in the available supply of salvage vehicles because traffic accidents decrease and fewer automobiles are damaged. Accordingly, mild weather can have an adverse effect on our salvage vehicle inventories, which would be expected to have an adverse effect on our revenue and operating results and related growth rates. Conversely, our inventories will tend to increase in poor weather such as a harsh winter or as a result of adverse weather-related conditions such as flooding. During periods of mild weather conditions, our ability to increase our revenues and improve our operating results and related growth will be increasingly dependent on our ability to obtain additional vehicle sellers and to compete more effectively in the market, each of which is subject to the other risks and uncertainties described in these sections. In addition, extreme weather conditions, although they increase the available supply of salvage cars, can have an adverse effect on our operating results. For example, during fiscal 2006, fiscal 2013 and fiscal 2018, we recognized substantial additional costs associated with Hurricanes Katrina, Rita, Sandy, and Harvey. Weather events have had, in certain quarters, an adverse effect on our operating results, in part because of yard capacity constraints in the impacted areas of the U.S. These additional costs were characterized as “abnormal” under ASC 330, *Inventory*, and included premiums for subhaulers, payroll, equipment and facilities expenses directly related to the operating conditions created by the hurricanes. In the event that we were to again experience extremely adverse weather or other anomalous conditions that result in an abnormally high number of salvage vehicles in one or more of our markets, those conditions could have an adverse effect on our future operating results.

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

Macroeconomic factors that affect oil prices and the automobile and commodity markets can have adverse effects on our revenues, revenue growth rates (if any), and operating results. 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, whether due to, among other things, a reduction in miles driven per car, vehicle-related technological advances such as accident avoidance systems and, to the extent widely adopted, the advent of autonomous vehicles, could have a material impact on revenue growth. In addition, under our Percentage Incentive Program contracts, which we refer to as PIP, the cost of transporting the vehicle to one of our facilities is included in the PIP fee. We may incur increased fees, which we may not be able to pass on to our vehicle sellers. A material increase in transportation rates could have a material impact on our operating results. Volatility in fuel, commodity, and used car prices could have a material adverse effect on our revenues and revenue growth rates in future periods.

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

We face significant competition for the supply of salvage and other vehicles and for the buyers of those vehicles. We believe our principal competitors include other auction and vehicle remarketing service companies with whom we compete directly in obtaining vehicles from insurance companies and other sellers, and large vehicle dismantlers, who

may buy salvage vehicles directly from insurance companies, bypassing the salvage sales process. Many of the insurance companies have established relationships with competitive remarketing companies and large dismantlers. Certain of our competitors may have greater financial resources than us. Due to the limited number of vehicle sellers, particularly in the U.K., and other foreign markets, the absence of long-term contractual commitments between us and our sellers and the increasingly competitive market environment, there can be no assurance that our competitors will not gain market share at our expense.

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

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

Participants in the vehicle sales industry are subject to, and may be required to expend funds to ensure compliance with a variety of governmental, regulatory and administrative rules, regulations, land use ordinances, licensure requirements and procedures, including but not limited to those governing vehicle registration, the environment, zoning and land use, and anti-money laundering. Failure to comply with present or future regulations or changes in interpretations of existing regulations may result in impairment of our operations and the imposition of penalties and other liabilities. At various times, we may be involved in disputes with local governmental officials regarding the development and/or operation of our business facilities. We believe that we are in compliance in all material respects with applicable regulatory requirements. We may be subject to similar types of regulations by federal, national, international, provincial, state and local governmental agencies in new markets. In addition, new regulatory requirements or changes in existing requirements may delay or increase the cost of opening new facilities, may limit our base of vehicle buyers and may decrease demand for our vehicles.

**Changes in laws or the interpretation of laws, including foreign laws and regulations, affecting the import and export of vehicles may have an adverse effect on our business and financial condition.**

Our internet-based auction-style model has allowed us to offer our products and services to international markets and has increased our international buyer base. As a result, foreign importers of vehicles now represent a significant part of our total buyer base. As a result our foreign buyers may be subject to a variety of foreign laws and regulations, including the imposition of import duties by foreign countries. Changes in laws, regulations, and treaties that restrict or impede or negatively affect the economics surrounding the importation of vehicles into foreign countries may reduce the demand for vehicles and impact our ability to maintain or increase our international buyer base. In addition, we and our vehicle buyers must work with foreign customs agencies and other non-U.S. governmental officials, who are responsible for the interpretation, application, and enforcement of these laws, regulations, and treaties. Any inability to obtain requisite approvals or agreements from such authorities could adversely impact the ability of our buyers to import vehicles into foreign countries. In addition, any disputes or disagreements with foreign agencies or officials over import duties, tariffs, or similar matters, including disagreements over the value assigned to imported vehicles, could adversely affect our costs and the ability and costs of our buyers to import vehicles into foreign countries. For example, in March 2008, a decree issued by the president of Mexico became effective that placed restrictions on the types of vehicles that can be imported into Mexico from the U.S. The adoption of similar laws or regulations in other jurisdictions that have the effect of reducing or curtailing our activities abroad, changes in the interpretation, application, and enforcement of laws, regulations, or treaties, any failure to comply with non-U.S. laws or regulatory interpretations, or any legal or regulatory interpretations or governmental actions that significantly increase our costs or the costs of our buyers could have a material adverse effect on our consolidated results of operations and financial position by reducing the demand for our products and services and our ability to compete in non-U.S. markets.



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

Our operations are subject to federal, state, national, international, provincial and local laws and regulations regarding the protection of the environment in the countries which we have storage facilities. In some cases, we may acquire land with existing environmental issues, including landfills as an example. In the salvage vehicle remarketing industry, large numbers of wrecked vehicles are stored at storage facilities and during that time, spills of fuel, motor oil and other fluids may occur, resulting in soil, surface water or groundwater contamination. In addition, certain of our facilities generate and/or store petroleum products and other hazardous materials, including waste solvents and used oil. In the U.K., we provide vehicle de-pollution and crushing services for end-of-life program vehicles. We could incur substantial expenditures for preventative, investigative or remedial action and could be exposed to liability arising from our operations, contamination by previous users of certain of our acquired facilities or facilities which we may acquire in the future, 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 consolidated results of operations and financial position.

**Adverse U.S. and international economic conditions may negatively affect our business, operating results, or financial condition.**

The capital and credit markets have historically experienced extreme volatility and disruption, which has in the past and may in the future lead to economic downturns in the U.S. and abroad. As a result of any economic downturn, the number of miles driven may decrease, which may lead to fewer accident claims, a reduction of vehicle repairs, and fewer salvage vehicles. Increases in unemployment, as a result of any economic downturn, may lead to an increase in the number of uninsured motorists. Uninsured motorists are responsible for disposition of their vehicle if involved in an accident. Disposition generally is either the repair or disposal of the vehicle. In the situation where the owner of the wrecked vehicle, and not an insurance company, is responsible for its disposition, we believe it is more likely that vehicle will be repaired or, if disposed, disposed through channels other than us. Adverse credit markets may also affect the ability of members to secure financing to purchase salvaged vehicles which may adversely affect demand. In addition, if the banking system or the financial markets deteriorate or are volatile, our credit facility or our ability to obtain additional debt or equity financing may be affected. These adverse economic conditions and events may have a negative effect on our business, consolidated results of operations and financial position.

**If we determine that our goodwill has become impaired, we could incur significant charges that would have a material adverse effect on our consolidated results of operations.**

Goodwill represents the excess of cost over the fair market value of assets acquired in business combinations. As of January 31, 2019, the amount of goodwill on our consolidated balance sheet subject to future impairment testing was \$338.0 million.

Pursuant to ASC 350, *Intangibles—Goodwill and Other*, we are required to annually test goodwill to determine if impairment has occurred, either through a quantitative or qualitative analysis. Additionally, interim reviews must be performed whenever events or changes in circumstances indicate that impairment may have occurred. If the testing performed indicates that impairment has occurred, we are required to record a non-cash impairment charge for the difference between the carrying value of the goodwill and the implied fair value of the goodwill in the period the determination is made. The annual goodwill impairment analysis, which was performed qualitatively in the fourth quarter of fiscal 2018, considered all relevant factors specific to our reporting units, including macroeconomic conditions; industry and market considerations; overall financial performance and relevant entity-specific events. Changes in these factors, or changes in actual performance could affect the fair value of goodwill, which may result in an impairment charge. For example, deterioration in worldwide economic conditions could affect these assumptions and lead us to determine that goodwill impairment is required. We cannot accurately predict the amount or timing of any impairment of assets. We considered the above factors noting none involved significant uncertainty. In addition, the industry in which we operate improved over the observable period, and our calculated fair value exceeded carrying value for each reporting unit by a substantial amount in our previous quantitative analysis, indicating no material risk

as of January 31, 2019, with respect to potential goodwill impairments. Should the value of our goodwill become impaired, it could have a material adverse effect on our consolidated results of operations and could result in our incurring net losses in future periods.

**Changes in federal, state and local, or foreign tax laws, changing interpretations of existing tax laws, or adverse determinations by tax authorities could increase our tax burden or otherwise adversely affect our financial condition or results of operations.**

We are subject to taxation at the federal, state, provincial, and local levels in the United States, the United Kingdom, and various other countries and jurisdictions in which we operate, including income taxes, sales taxes, value-added (VAT) taxes, and similar taxes and assessments. The laws and regulations related to tax matters are extremely complex and subject to varying interpretations. Although we believe our tax positions are reasonable, we are subject to audit by the Internal Revenue Service in the United States, HM Revenue and Customs in the United Kingdom, state tax authorities in the states in which we operate, and other similar tax authorities in international jurisdictions. As previously disclosed, we have been subject to challenge by the Georgia Department of Revenue with respect to sales

taxes and could face similar audits or challenges from applicable federal, state, or foreign tax authorities in the future. While we believe we comply with all applicable tax laws, rules, and regulations in the relevant jurisdictions, tax authorities may elect to audit us and determine that we owe additional taxes, which could result in a significant increase in our liabilities for taxes, interest, and penalties in excess of our accrued liabilities.

New tax legislative initiatives may be proposed from time to time, such as proposals for comprehensive tax reform in the United States, which may impact our effective tax rate and which could adversely affect our tax positions or tax liabilities. Our future effective tax rate could be adversely affected by, among other things, changes in the composition of earnings in jurisdictions with differing tax rates, changes in statutory rates and other legislative changes, changes in interpretations of existing tax laws, or changes in determinations regarding the jurisdictions in which we are subject to tax. From time to time, U.S. federal, state and local, and foreign governments make substantive changes to tax rules and their application, which could result in materially higher taxes than would be incurred under existing tax law and which could adversely affect our financial condition or results of operations.

The Tax Cuts and Jobs Act (“Tax Reform” or “Tax Act”) was enacted on December 22, 2017. The Tax Act significantly revamped U.S. taxation of corporations, including a reduction of the federal income tax rate from 35% to 21%, a repeal of the exceptions to the \$1.0 million deduction limitation for performance-based compensation to covered employees, and a new tax regime for foreign earnings. The repeal of the \$1.0 million deduction limit for performance-based compensation, the new U.S. taxes on accumulated and future foreign earnings and other adverse changes resulting from the Tax Act, or a change in the mix of domestic and foreign earnings, might offset the benefit from the reduced tax rate, and our future effective tax rates and/or cash taxes may increase, even significantly, or not decrease much, compared to recent or historical trends. Many of the provisions of the Tax Act are highly complex and may be subject to further interpretive guidance from the IRS or others. Some of the provisions of the Tax Act may be changed by a future Congress or challenged by the World Trade Organization (“WTO”). Although we cannot predict the nature or outcome of such future interpretive guidance, or actions by a future Congress or WTO, they could adversely impact our consolidated results of operations and financial position.

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

The Financial Accounting Standards Board, the Public Company Accounting Oversight Board, and the SEC, from time to time issue new pronouncements or new interpretations of existing accounting standards that require changes to our accounting policies and procedures. To date, we do not believe any new pronouncements or interpretations have had a material adverse effect on our consolidated results of operations and financial position, but future pronouncements or interpretations could require a change or changes in our policies or procedures.

**Fluctuations in foreign currency exchange rates could result in declines in our reported revenues and earnings.**

Our reported revenues and earnings are subject to fluctuations in currency exchange rates. We do not engage in foreign currency hedging arrangements; consequently, foreign currency fluctuations may adversely affect our revenues and earnings. Should we choose to engage in hedging activities in the future we cannot be assured our hedges will be effective or that the costs of the hedges will exceed their benefits. Fluctuations in the rate of exchange between the U.S. dollar and foreign currencies, primarily the British pound, Canadian dollar, Brazilian real, European Union euro, U.A.E. dirham, Omani rial, and Bahraini dinar could adversely affect our consolidated results of operations and financial position.

On June 23, 2016, the U.K. held a referendum in which voters approved an exit from the European Union, commonly referred to as “Brexit.” In February 2017, the British Parliament voted in favor of allowing the British government to begin negotiating the terms of the U.K.’s withdrawal from the European Union and discussions with the European Union began in March 2017. Adverse consequences concerning Brexit or the European Union could include deterioration in global economic conditions, instability in global financial markets, political uncertainty, volatility in currency exchange rates, or adverse changes in the cross-border agreements currently in place, any of which could have an adverse impact on our financial results in the future. The ultimate effects of Brexit on us will also depend on the terms of agreements, if any, that the U.K. and the European Union make to retain access to each other’s respective markets either during a transitional period or more permanently.



**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Unregistered Sales of Equity Securities**

None.

**Issuer Purchases of Equity Securities**

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 <sup>(1)</sup>
<i>Fiscal 2019</i>				
First Quarter	—	\$—	—	89,086,398
November 1, 2018 through November 30, 2018	—	\$—	—	89,086,398
December 1, 2018 through December 31, 2018	5,777,451	\$47.63	5,777,451	83,308,947
January 1, 2019 through January 31, 2019	1,858,145	\$48.44	1,858,145	81,450,802

The Company's stock repurchase program was announced on February 20, 2003. On September 22, 2011, the Company's board of directors approved an 80 million share increase in the Company's stock repurchase program, bringing the total current authorization to 196 million (1) shares. The repurchase 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 stock repurchase program. Subject to applicable securities laws, such repurchases will be made at such times and in such amounts as the Company deems appropriate and may be discontinued at any time.

**ITEM 6. EXHIBITS**

a) Exhibits

- 3.1 Copart, Inc. Certificate of Incorporation
  - 3.2 Certificate of Amendment to the Copart, Inc. Certificate of Incorporation
  - 3.3 Bylaws of Copart, Inc.
  - 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1(1) Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2(1) Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 101.INS XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
  - 101.SCH XBRL Taxonomy Extension Schema Document
  - 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
  - 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
  - 101.LAB XBRL Taxonomy Extension Label Linkbase Document
  - 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- (1) In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 33-8238 and 34-47986, Final Rule: Management’s Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed “filed” for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COPART, INC.

/s/ Jeffrey Liaw

Jeffrey Liaw, Chief Financial Officer (Principal Financial and Accounting Officer and duly Authorized Officer)

Date: February 28, 2019