

COPART INC
Form 10-Q
March 11, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

OR

- o** **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to**

Commission file number: 0-23255

COPART, INC.

(Exact name of registrant as specified in its charter)

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California
(State or other jurisdiction
of incorporation or organization)

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

4665 Business Center Drive, Fairfield, CA 94534

(Address of principal executive offices with zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-Accelerated Filer ☐

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

YES ☐ NO ☒

Number of shares of Common Stock outstanding as of March 10, 2008: 88,199,381

Copart, Inc.

Index to the Quarterly Report

January 31, 2008

Description

<u>PART I Financial Information</u>	3
<u>Item 1 Financial Statements</u>	3
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Income</u>	4
<u>Consolidated Statements of Cash Flows</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Overview</u>	15
<u>Acquisitions and New Operations</u>	16
<u>Critical Accounting Policies and Estimates</u>	16
<u>Results of Operations</u>	20
<u>Liquidity and Capital Resources</u>	22
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	23
<u>Item 4 Controls and Procedures</u>	23
<u>Evaluation of Disclosure Controls and Procedures</u>	23
<u>Changes in Internal Controls</u>	23
<u>PART II Other Information</u>	24
<u>Item 1 Legal Proceedings</u>	24
<u>Item 1A Risk Factors</u>	24
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
<u>Item 3 Defaults upon Senior Securities</u>	32
<u>Item 4 Submission of Matters to a Vote of Security Holders</u>	32
<u>Item 5 Other Information</u>	32
<u>Item 6 Exhibits</u>	33
<u>Signatures</u>	34

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

	January 31, 2008	July 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 173,225	\$ 98,365
Short-term investments		102,625
Accounts receivable, net	137,286	109,895
Vehicle pooling costs	35,231	28,842
Inventories	7,356	5,999
Income taxes receivable	1,700	3,208
Prepaid expenses and other assets	6,820	5,518
Total current assets	361,618	354,452
Restricted cash and investments		9,148
Property and equipment, net	459,321	420,664
Intangibles, net	26,353	27,442
Goodwill	165,976	161,645
Deferred income taxes	12,120	7,785
Land purchase options and other assets	27,515	24,208
Total assets	\$ 1,052,903	\$ 1,005,344
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 90,934	\$ 85,082
Deferred revenue	16,033	13,897
Income taxes payable	3,010	3,930
Deferred income taxes	2,575	3,219
Other current liabilities	462	474
Total current liabilities	113,014	106,602
Deferred income taxes	13,554	13,998
Other liabilities	4,492	3,878
Total liabilities	131,060	124,478
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value - 180,000 shares authorized; 88,169 and 88,334 shares issued and outstanding at January 31, 2008 and July 31, 2007, respectively	183,937	206,126
Accumulated other comprehensive income	1,600	4,447
Retained earnings	736,306	670,293
Total shareholders' equity	921,843	880,866
Total liabilities and shareholders' equity	\$ 1,052,903	\$ 1,005,344

See accompanying notes to unaudited consolidated financial statements.

Copart, Inc.

Consolidated Statements of Income

(in thousands except per share amounts)

(Unaudited)

	Three months ended January 31,		Six months ended January 31,	
	2008	2007	2008	2007
Revenues	\$ 173,459	\$ 128,925	\$ 357,416	\$ 261,046
Operating costs and expenses:				
Yard operations	104,851	68,536	210,415	138,767
General and administrative	21,373	15,225	43,138	30,223
Total operating expenses	126,224	83,761	253,553	168,990
Operating income	47,235	45,164	103,863	92,056
Other income (expense):				
Interest income, net	2,472	3,283	5,216	6,310
Other income	882	245	1,677	895
Equity in losses of unconsolidated investment				(2,216)
Total other income	3,354	3,528	6,893	4,989
Income before income taxes	50,589	48,692	110,756	97,045
Income taxes	18,563	18,300	41,120	36,310
Net income	\$ 32,026	\$ 30,392	\$ 69,636	\$ 60,735
Earnings per share-basic				
Basic net income per share	\$ 0.36	\$ 0.33	\$ 0.79	\$ 0.67
Weighted average common shares outstanding	88,802	90,752	88,684	90,625
Earnings per share-diluted				
Diluted net income per share	\$ 0.35	\$ 0.32	\$ 0.76	\$ 0.65
Weighted average common shares and dilutive potential common shares outstanding	91,333	93,682	91,261	93,523

See accompanying notes to unaudited consolidated financial statements.

Copart, Inc.

Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Six Months Ended January 31,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 69,636	\$ 60,735
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	22,086	17,539
Allowance for doubtful accounts	92	(249)
Deferred rent	89	101
Share-based compensation	3,569	1,685
(Gain)/loss on sale of property and equipment	(241)	416
Deferred income taxes	(3,791)	(2,014)
Equity in loss of unconsolidated entity		2,216
Changes in operating assets and liabilities, net of effects from acquisition:		
Accounts receivable	(26,447)	(11,965)
Vehicle pooling costs	(6,220)	(1,976)
Inventory	(1,257)	(47)
Prepaid expenses and other current assets	(1,325)	931
Land purchase options and other assets	(3,346)	147
Accounts payable and accrued liabilities	4,942	(1,984)
Deferred revenue	2,135	(645)
Income taxes receivable	1,506	690
Income taxes payable	(6,933)	(3,966)
Net cash provided by operating activities	54,495	61,614
Cash flows from investing activities:		
Purchases of short-term investments	(154,360)	(428,055)
Sales of short-term investments	256,985	380,895
Release of restricted cash and investments	9,148	
Purchases of property and equipment	(58,261)	(37,355)
Proceeds from sale of property and equipment	2,845	5,826
Purchase of assets and liabilities in connection with acquisition, net of cash acquired	(9,885)	
Net cash provided by (used in) investing activities	46,472	(78,689)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	8,492	9,275
Proceeds from the issuance of Employee Stock Purchase Plan shares	792	779
Repurchases of common stock	(40,948)	
Excess tax benefit from share-based payment arrangements	5,905	4,409
Net cash (used in) provided by financing activities	(25,759)	14,463
Effect of foreign currency translation	(348)	75
Net increase (decrease) in cash and cash equivalents	74,860	(2,537)
Cash and cash equivalents at beginning of period	98,365	126,590
Cash and cash equivalents at end of period	\$ 173,225	\$ 124,053

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Supplemental disclosure of cash flow information:

Income taxes paid	\$	45,150	\$	37,192
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See accompanying notes to unaudited consolidated financial statements.

Copart, Inc.

Notes to Consolidated Financial Statements

January 31, 2008

(Unaudited)

NOTE 1 Summary of Significant Accounting Policies

Description of Business

Copart, Inc. (the Company) provides vehicle suppliers, primarily insurance companies, with a full range of services to process and sell salvage vehicles primarily over the Internet through the Company's Virtual Bidding Second Generation (VB) Internet auction-style sales technology. The Company sells principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters. Salvage vehicles are either damaged vehicles deemed a total loss for insurance or business purposes or are recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. The Company offers vehicle remarketing services that expedite each stage of the salvage vehicle sales process and minimize administrative and processing costs.

Principles of Consolidation

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

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

Use of Estimates

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

Income Taxes

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

In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-An Interpretation of FASB Statement No. 109* (FIN 48), which is a change in accounting for income taxes. FIN 48 specifies how tax benefits for uncertain tax positions are to be recognized, measured, and

derecognized in financial statements; requires certain disclosures of uncertain tax positions; specifies how reserves for uncertain tax positions should be classified on the balance sheet; and provides transition and interim-period guidance, among other provisions. FIN 48 is effective for fiscal years beginning after December 15, 2006 and as a result, was effective for the Company on August 1, 2007. See Note 13 for additional information, including the effects of adoption of FIN 48 on the Company's consolidated financial statements.

Foreign Currency Translation

The Canadian Dollar and the British Pound are the functional currencies of the Company's foreign subsidiaries, Copart Canada and Copart UK, respectively, as they are the primary currencies within the economic environment in which each subsidiary operates. 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.

Revenue Recognition

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

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

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

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

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

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accounting. The fees for the auction service are recognized upon completion of the sale, and the fees for the post-sale services are recognized upon successful completion of those services using the residual method.

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

NOTE 2 Vehicle Pooling Costs

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

NOTE 3 Net Income Per Share

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2008	2007	2008	2007
Basic weighted average shares outstanding	88,802	90,752	88,684	90,625
Effect of dilutive securities - stock options	2,531	2,930	2,577	2,898
Diluted weighted average shares outstanding	91,333	93,682	91,261	93,523

Options to purchase 40,000 shares of common stock at a weighted average price of \$40.44 per share were outstanding during the three months ended January 31, 2008 (none during the three months ended January 31, 2007), and options to purchase 40,000 and 110,000 shares of common stock at a weighted average price of \$40.44 and \$29.76 were outstanding during the six months ended January 31, 2008 and 2007, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares during the respective periods.

NOTE 4 Short-term Investments

Short-term investments consist primarily of AAA-rated auction rate securities with readily determinable fair market values and with original maturities in excess of three months. Auction rate securities are principally variable rate securities tied to short-term interest rates. Auction rate securities have interest rate resets through a modified Dutch auction, at predetermined short-term intervals, usually every 7, 28 or 35 days. They trade at par and are callable at par on any interest payment date at the option of the issuer. Interest paid during a given period is based upon the interest rate determined during the prior auction. Although these instruments are issued and rated as long-term securities, they are priced and traded as short-term securities because of the liquidity provided through the interest rate reset. As of January 31, 2008 the Company had no short-term investments.

The Company has classified its entire investment portfolio as available-for-sale. The Company views its available-for-sale securities as available for use in its current operations. The Company has classified auction rate securities as short-term, even though the stated maturity may be one year or more beyond the current balance sheet date. Available-for-sale securities are reported at fair value, with unrealized gains and losses reported as a component of Shareholders' Equity and Comprehensive Income. Unrealized losses are charged against income when a decline in the fair market value of an individual security is determined to be other than temporary. Realized gains and losses on investments are included in interest income.

Short-term investments consist of the following (in thousands):

	January 31, 2008	July 31, 2007
Available-for-sale securities:		

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Auction rate securities	\$	\$	102,625
Total short-term investments	\$	\$	102,625

NOTE 5 Goodwill and Intangible Assets

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

	January 31, 2008		July 31, 2007	
Amortized intangibles:				
Covenants not to compete	\$	10,071	\$	10,071
Supply contracts		23,699		21,889
Tradename		3,120		2,964
Software		1,643		1,780
Licenses and databases		334		318
Accumulated amortization		(12,514)		(9,580)
Net intangibles	\$	26,353	\$	27,442

Aggregate amortization expense on amortizable intangible assets was \$1.8 million and \$0.2 million for the three months ended January 31, 2008 and 2007, respectively and \$3.7 million and \$0.4 million for the six months ended January 31, 2008 and 2007, respectively.

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

Balance as of July 31, 2007	\$	161,645
Goodwill recorded during the period		5,584
Effect of foreign currency exchange rates		(1,253)
Balance as of January 31, 2008	\$	165,976

NOTE 6 Share-Based Compensation

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

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

	Shares (in 000s)	Weighted- average Exercise Price	Weighted-average Remaining Contractual Term	Aggregate Intrinsic Value (in 000s)
Outstanding at July 31, 2007	5,230	\$ 13.21		
Grants of options	1,070	\$ 34.34		
Exercises	(746)	\$ 10.72		
Forfeitures or expirations	(36)	\$ 20.13		
Outstanding at January 31, 2008	5,518	\$ 17.60	5.26	\$ 128,476
Exercisable at January 31, 2008	3,673	\$ 11.67	3.52	\$ 107,298

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the 5,478,418 options that were in-the-money at January 31, 2008.

The Company recorded approximately \$3.6 million of share-based compensation expense during the six months ended January 31, 2008.

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

NOTE 7 Common Stock Repurchases

In October 2007, the Company's board of directors approved a 20 million share increase in the Company's stock repurchase program bringing the total current number of shares authorized for repurchase to 29 million shares. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. The 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 approximately 983,000 shares at a weighted average price of \$41.67 during the six months ended January 31, 2008 and did not repurchase any shares during the six months ended January 31, 2007. The total number of shares repurchased under the program as of January 31, 2008 was approximately 8 million leaving approximately 21 million available under the repurchase program.

NOTE 8 Segments and Other Geographic Reporting

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

The following geographic data is provided in accordance with SFAS No. 131. Revenues are based upon the geographic location of the selling facility and are summarized in the following table (in thousands):

	Three Months Ended January 31,		Six Months Ended January 31,	
	2008	2007	2008	2007
United States	\$ 136,417	\$ 128,028	\$ 275,318	\$ 259,229
Canada	1,227	897	2,501	1,817
North America	137,644	128,925	277,819	261,046
United Kingdom	35,815		79,597	
	\$ 173,459	\$ 128,925	\$ 357,416	\$ 261,046

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

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	January 31	
	2008	2007
United States	\$ 544,325	\$ 491,576
Canada	5,805	4,829
North America	550,130	496,405
United Kingdom	141,155	
	\$ 691,285	\$ 496,405

NOTE 9 Comprehensive Income

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2008	2007	2008	2007
Net income, as reported	\$ 32,026	\$ 30,392	\$ 69,636	\$ 60,735
Other comprehensive income:				
Foreign currency translation adjustments, net of tax effects	(6,981)	427	(2,847)	(68)
Total other comprehensive income	\$ 25,045	\$ 30,819	\$ 66,789	\$ 60,667

NOTE 10 Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the potential impact on its consolidated results of operations and financial position.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred: for example, debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by us in the first quarter of fiscal 2009. The Company is currently determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS 159 may have on its consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, (SFAS No. 141R) which provides revised guidance on the accounting for acquisitions of businesses. This standard changes the current guidance to require that all acquired assets, liabilities, minority interest and certain contingencies be measured at fair value, and certain other acquisition-related costs be expensed rather than capitalized. SFAS No. 141(R) will apply to acquisitions that are effective after December 31, 2008, and application of the standard to acquisitions prior to that date is not permitted. In the event of an acquisition, the Company will need to evaluate whether or not SFAS No. 141R will have a material impact on its consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, (SFAS No. 160) which provides guidance on the presentation of minority interest in the financial statements. This standard requires that minority interest be presented as a component of equity rather than as a mezzanine item between liabilities and equity, and also requires that minority interest be presented as a separate caption in the income statement. This standard also requires all transactions with minority interest holders, including the issuance and repurchase of minority interests, be accounted for as equity transactions unless a change in control of the subsidiary occurs. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company does not believe SFAS No. 160 will have a material impact on its consolidated results of operations and financial position.

NOTE 11 Equity Investment and Related Party Transaction

During the year ended July 31, 2006, the Company paid approximately \$9.0 million for a non-controlling equity interest in Lanelogic, a Delaware limited liability corporation (Lanelogic). The Company has no further contractual funding commitment. Based on the Company's evaluation of Lanelogic and the related agreements, management believes that Lanelogic does not constitute a Variable Interest Entity as defined in FIN No. 46, *Consolidation of Variable Interest Entities*. As a result, the Company's investment has been accounted for under the equity method prescribed by APB No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

During the second quarter ended January 31, 2007, the Company's Chairman and CEO made a personal unsecured loan to Lanelogic to prevent a restriction of working capital from disrupting its business as Lanelogic sought additional equity financing. The loan was repaid during the second quarter ended January 31, 2007. The Company has concluded that

the personal unsecured loan did not cause a change in the accounting of LaneLogic as an equity method investment. During the second quarter ended January 31, 2007, LaneLogic received a strategic equity investment totaling approximately \$10 million from two new investment groups as well as LaneLogic's founder. The Company did not participate in this additional equity financing into LaneLogic. In addition, LaneLogic converted from a limited liability company to a Delaware Corporation, of which the Company is now a stockholder.

On August 15, 2007, the Company's Chairman and CEO provided a personal guaranty in favor of Dealer Services Corporation as a condition for providing a credit facility to LaneLogic. The guaranty was approved by the Company's Audit Committee. The Company has concluded that the personal guaranty does not cause a change in the accounting of LaneLogic as an equity method investment.

The Company has discontinued recording its share of the losses of LaneLogic because it has no commitment to provide further funding.

On February 15, 2008 the Company exercised its option to purchase land that was leased from the Estate of James P. Meeks, the deceased father of James E. Meeks who is the former Executive Vice President and Chief Operating Officer and current Board member of the Company. The purchase price was established through two appraisals and the transaction was approved by the Audit Committee of our Board of Directors.

NOTE 12 Legal Proceedings

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

On September 16, 2005, Richard M. Gray filed suit against Copart of Connecticut, Inc. and A. Safrin in the State Court of the County of Chatham, State of Georgia, alleging a class action for unreasonable amounts claimed for storage liens by the Company, and related claims. Relief sought includes class certification, damages, fees, costs and expenses. The Company's motion for summary judgment was heard on January 31, 2007 and was denied. Subsequent thereto, the parties agreed to settle the case without any admission of liability or wrongdoing and a dismissal with prejudice was filed on January 23, 2008.

On July 28, 2006, Foreign Car Sales and Service LLC (FCS) filed suit against Copart in the United States District Court for the Middle District of Louisiana, originally alleging antitrust violations and unfair trade practices. Relief sought originally included class certification based on both unfair trade practices and Sherman Act violations, damages, fees, costs and expenses. On January 5, 2007 the Magistrate required FCS to amend its complaint. A First Amended Complaint was rejected, and a Second Amended Complaint was submitted February 16, 2007, in which FCS abandoned its unfair trade practices claims, and now relies simply on breach of contract claims. On August 23, 2007, the Company filed: (a) Motion to Dismiss Claims for Improper Venue; (b) Motion to Dismiss for Failure to Join Persons Needed for Just Adjudication; (c) Motion To Dismiss for Lack of Diversity Jurisdiction; (d) Motion to Dismiss Load Out Fee Class Action for Failure to State Claim; and (e) Motion to Dismiss Load Out Fee Class Action for Lack of Diversity Jurisdiction. On February 22, 2008, the court granted the motions to dismiss with regard to all claims, leaving only the anti-trust claim pending. The Company believes the remaining antitrust claim is without merit, and is defending the lawsuit vigorously.

On November 20, 2007, Car Auction & Reinsurance Solutions, Inc. (CARS, Inc.) filed suit against Copart in the Superior Court in the County of New Castle, Delaware. CARS is seeking \$2 million in damages, punitive damages, and prejudgment interest related to allegations involving

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breach of contract and misrepresentation. The Company believes the claim is without merit, and is defending the lawsuit vigorously.

On November 30, 2007, Tracy Utterback Suggs filed suit against Copart in Harris County, Texas District Court. The complaint alleges breach of contract and negligent spoliation of evidence on grounds that the Company allowed a vehicle in its possession to be destroyed. Relief sought includes damages, exemplary damages and prejudgment interest. At this time, Plaintiff has made a demand through counsel of \$50 million. The Company believes the Plaintiff's spoliation lawsuit against the Company is without merit and intends to defend the lawsuit vigorously.

On April 18, 2007 Heather Trafton, as Personal Representative of the Estate of Larry Trafton, filed a wrongful death suit against Carlos Sigas Start Auto and Copart in the Circuit Court of the Thirteenth Judicial Circuit of Florida in the County of Hillsborough, Florida. Plaintiff alleges Manuel Vega, a driver for independent tow company Carlos Sigas, caused the

death of decedent, motorcyclist Larry Trafton, because Vega ran a red light and collided with Trafton at an intersection. Although neither Sigas nor Vega are employees of the Company, Plaintiff alleges the Company is responsible for the wrongful death of Trafton. On or about February 6, 2008, the Company received Plaintiff's initial monetary demand in the amount of \$6 million. The Company believes the claim is without merit and is defending the lawsuit vigorously.

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

NOTE 13 Income Taxes

The Company adopted the provisions of FIN 48, as of the beginning of fiscal 2008. For benefits to be realized, a tax position must be more likely than not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement.

As a result of the Company's adoption of FIN 48, as of August 1, 2007, the Company recognized a \$3.6 million cumulative decrease to retained earnings. The Company also recognized a liability for unrecognized tax benefits of \$13.3 million, of which \$9.1 million (net of tax) would reduce the Company's effective tax rate if recognized in future periods. The interest and penalties, if any, related to unrecognized tax benefits are recorded in income tax expense. As of the beginning of fiscal 2008, the Company had \$2.6 million of accrued interest and penalties included in unrecognized tax benefits.

As of January 31, 2008, there has been no material change to the amount of unrecognized tax benefits. The Company does not anticipate that the total gross unrecognized tax benefit will change significantly by the end of fiscal year 2008.

The Company files income tax returns in the U.S. federal jurisdiction, various states, Canada and United Kingdom. With some exceptions, the Company is no longer subject to U.S. federal, state/local, or non-U.S. income tax examinations by tax authorities for years prior to fiscal year 2000. The Company expects the commencement of certain state tax audits in the near term. At this time, the Company does not believe that the outcome of any examination will have a material impact on the Company's financial statements.

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

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On December 20, 2007 we were notified that the Internal Revenue Service will examine our U. S. Corporation Income Tax Return, Form 1120 for the tax period ending July 31, 2006.

NOTE 14 Acquisitions

In August 2007, the Company completed the acquisition of Century Salvage Sales Limited (Century), a vehicle salvage disposal company with three facilities located in the UK. This acquisition was completed because of its strategic fit with the United Kingdom business. The acquisition has been accounted for using the purchase method in accordance with SFAS No. 141, *Business Combinations*, which has resulted in the recognition of goodwill in the Company's consolidated financial statements. This goodwill arises because the purchase price for Century reflects a number of factors including its future earnings and cash flow potential; the multiple to earnings, cash flow and other factors at which similar businesses have been purchased by other acquirers, the competitive nature of the process by which the Company acquired the business; and because of the complementary strategic fit and resulting synergies it brings to existing operations. In accordance with SFAS No. 141, Century's assets acquired and liabilities assumed have been recorded at their estimated fair values.

In June 2007, the Company completed the acquisition of Universal Salvage plc (Universal) (the Acquisition). Universal, based in the UK, operates seven salvage yards in the UK and is a leading service provider to the motor insurance and automotive industries. Universal specializes in the disposal of accident-damaged, End-of-Life and fee-based non-salvage vehicles. The Acquisition has been accounted for using the purchase method in accordance with SFAS No. 141, *Business Combinations*, which has resulted in the recognition of goodwill in the Company's consolidated financial statements. This goodwill arises because the purchase price for Universal reflects a number of factors including its future earnings and cash flow potential; the multiple to earnings, cash flow and other factors at which similar businesses have been purchased by other acquirers, the competitive nature of the process by which the Company acquired the business; and because of the complementary strategic fit and resulting synergies it brings to existing operations.

The Company has arranged to obtain additional information regarding certain asset valuations related to these acquisitions. The Company believes the potential changes to its preliminary purchase price allocation will not have a material impact on the Company's consolidated results of operations and financial position.

The Company has included the operating results of Century and Universal in its consolidated financial statements from the date of acquisition.

NOTE 15 Reclassifications

The Company has determined that in the first quarter of fiscal 2008, it included \$3.0 million in general and administrative costs and \$.4 million in general and administrative depreciation from our UK operations that, in order to be consistent with US classification, should have been reflected in yard operations. The reclassifications of these costs, which have no effect on the current quarter, are reflected in the year to date results.

NOTE 16 Subsequent Events

On February 14, 2008 the Company entered into a definitive agreement to acquire all the outstanding shares of Simpson Bros (York) Holdings Limited, a United Kingdom LLC which operates one location in York, England. Simpson's primary business activity was the dismantling of automobiles and the sales of salvaged auto parts. The Company expects this transaction to close by April 4, 2008. The purchase price is not considered to be material to the balance sheet of the Company.

On February 29, 2008, the Company purchased the assets and business of AG Watson Auto Salvage & Motors Spares (Scotland) Limited which operates two salvage locations in Scotland and two salvage locations in northern England. The purchase price is not considered to be material to the balance sheet of the Company.

On March 6, 2008, the Company entered into an unsecured credit agreement with Bank of America, N.A. (the Credit Agreement) providing for a \$200 million revolving credit facility (the Credit Facility), including a \$100 million foreign currency borrowing sublimit and a \$50 million letter of credit sublimit. Amounts borrowed under the Credit Facility may be used for repurchases of stock, capital expenditures, working capital and other general corporate purposes. The Credit Facility matures and all outstanding borrowings are due on the fifth anniversary of the Credit Agreement (the Maturity Date), with annual reductions in availability of \$25 million on each of the first three anniversaries. Amounts borrowed under the Credit Facility may be repaid and reborrowed until the Maturity Date and bear interest, at the Company's option, at either Eurocurrency

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Rate plus .5% to .875%, depending of the leverage ratio, as defined in the Credit Agreement, at the end of the previous quarter or at the prime rate. A default interest rate applies on all obligations during an event of default under the Credit Facility at a rate per annum equal to 2.0% above the otherwise applicable interest rate. The Credit Facility requires the Company to pay a commitment fee on the unused portion of the Credit Facility. The commitment fee ranges from 0.075% to 0.15% depending on the leverage ratio as of the end on the previous quarter. The Credit Facility contains customary representations and warranties and places certain business operating restrictions on the Company relating to, among other things, indebtedness, liens and other encumbrances, investments, mergers and acquisitions, asset sales, and dividends, distributions and redemptions of capital stock. In addition, the Credit Agreement provides for a maximum total leverage ratio and a minimum interest coverage ratio. The Credit Facility contains events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, cross-defaults to certain other indebtedness, bankruptcy and insolvency defaults, material judgments, invalidity of the loan documents and events constituting a change of control. The Credit Facility is guaranteed by the Company's material domestic subsidiaries.

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 report involve known and unknown risks, uncertainties and situations that may cause our or our industry's actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. These factors include those listed in Part I, Item 1A. - Risk Factors beginning on page 24 of this Quarterly Report on Form 10-Q and those discussed elsewhere in this Quarterly Report on Form 10-Q. We encourage investors to review these factors carefully together with the other matters referred to herein, as well as in the other documents we file with the Securities and Exchange Commission (the SEC). The Company may from time to time make additional written and oral forward-looking statements, including statements contained in the Company's filings with the SEC. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

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

Overview

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We provide vehicle suppliers, primarily insurance companies, with a full range of remarketing services to process and sell vehicles primarily over the Internet through our Virtual Bidding Second Generation, or VB², Internet auction-style sales technology. In the United Kingdom, or UK, we sell salvage vehicles through a combination of live auctions and Internet bidding. We sell principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters. Salvage vehicles are either damaged vehicles deemed a total loss 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 suppliers a full range of remarketing services that expedite each stage of the salvage vehicle sales process and minimize administrative and processing costs. In North America, we sell vehicles primarily as an agent and derive revenue primarily from fees paid by vehicle suppliers and vehicle buyers as well as related fees for services such as towing and storage. In the UK, we operate primarily on a principal basis, purchasing the salvage vehicle outright from the insurance companies and reselling the vehicle for our own account to buyers through a combination of live auctions and Internet sales.

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

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

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

Acquisitions and New Operations

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We have experienced significant growth as we have acquired seventeen vehicle storage facilities and established ten new facilities since the beginning of fiscal 2006. All of these acquisitions have been accounted for using the purchase method of accounting.

As part of our overall expansion strategy of offering integrated services to vehicle suppliers, we anticipate acquiring and developing facilities in new regions, as well as the regions currently served by our facilities. As part of this strategy, in fiscal 2008 we acquired three new facilities in the UK located in Peterlee, Wisbech, and Rochford, and in North America we opened new facilities in London, Ontario, Windsor, New Jersey and Walton Kentucky. In fiscal 2007 we acquired seven new facilities in the UK located in Sandy, Sandtoft, Sandwich, Westbury, Chester, Denny, and Wootton, and in North America we opened new facilities in Baltimore, Maryland, Woodburn, Oregon and Punta Gorda, Florida. In fiscal 2006 we acquired new facilities in or near Greenwood, Nebraska; Grand Island, Nebraska; York Haven, Pennsylvania; Chambersburg, Pennsylvania; Altoona, Pennsylvania; Fruitland, Maryland; Billings, Montana and opened new facilities in or near Honolulu, Hawaii; Lansing, Michigan; Dover, Florida and Jacksonville, Florida. We believe that these acquisitions and openings strengthen our coverage as we have 137 facilities located in North America and the United Kingdom and are able to provide national coverage for our suppliers.

During the fourth quarter of fiscal 2007, we acquired all the issued share capital of Universal Salvage plc, or Universal, for £2.00 per share (approximately \$3.94 based on currency exchange rates on June 14, 2007). Universal, based in the UK and operating exclusively within the UK, is a service provider to the motor insurance and automotive industries. The aggregate acquisition consideration paid by us totaled approximately £60.7 million (approximately \$120.0 million based on currency exchange rates on June 14, 2007) and was funded from our available cash resources. We also assumed outstanding indebtedness of Universal totaling approximately £2.3 million (\$4.5 million as of June 14, 2007). This acquisition marked our first acquisition outside North America and included the seven facilities discussed above. In addition, during the first quarter of fiscal 2008, we completed the acquisition of Century Salvage Sales Limited, or Century, a vehicle salvage disposal company with three facilities located in the UK.

On February 14, 2008 we entered into a definitive agreement to acquire all the outstanding shares of Simpson Bros (York) Holdings Limited, a United Kingdom LLC which operates one location in York, England. Simpson's primary business activity was the dismantling of automobiles and the sales of salvaged auto parts. We expect this transaction to close by April 4, 2008. The purchase price is not considered to be material to our balance sheet.

On February 29, 2008 we purchased the assets and business of AG Watson Auto Salvage & Motors Spares (Scotland) Limited which operates two salvage locations in Scotland and two salvage locations in northern England. The purchase price is not considered to be material to our balance sheet.

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

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

Critical Accounting Policies and Estimates

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The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to vehicle pooling costs, allowance for doubtful accounts, goodwill, income taxes, long-lived assets and self insured liabilities. We base our estimates on historical experience

and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

Revenue Recognition

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

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

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

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

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

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

Vehicle Pooling Costs

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

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

Allowance for Doubtful Accounts

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

Valuation of Goodwill

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

Income Taxes and Deferred Tax Assets

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We are required to estimate income tax provisions and amounts ultimately payable or recoverable in numerous jurisdictions. Such estimates involve significant interpretations of regulations and are inherently very complex. Resolution of income tax treatments in individual jurisdictions may not be known for many years after completion of any fiscal year.

We evaluate the realizability of our deferred tax assets on an ongoing basis. US generally accepted accounting principles require the assessment of our performance and other relevant factors when determining the need for a valuation allowance with respect to these deferred tax assets. Our ability to realize deferred tax assets is dependent on the Company's ability to generate future taxable income. Accordingly, we have established a valuation allowance when, in certain taxable jurisdictions, the utilization of the tax asset is uncertain. Additional timing differences, future earning trends and/or tax strategies may occur which could warrant a need for establishing an additional valuation allowance or a reserve.

Long-lived Asset Valuation, including Intangible Assets

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

Stock-Based Compensation

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

Retained Insurance Liabilities

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

Recently Issued Accounting Standards

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In September 2006, FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the potential impact on our consolidated results of operations and financial position.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred: for example, debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by us in the first quarter of fiscal 2009. We are currently determining whether fair value accounting is appropriate for any of our eligible items and cannot estimate the impact, if any, which SFAS 159 will have on our consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, (SFAS No. 141R) which provides revised guidance on the accounting for acquisitions of businesses. This standard changes the current guidance to require that all acquired assets, liabilities, minority interest and certain contingencies be measured at fair value, and certain other acquisition-related costs be expensed rather than capitalized. SFAS No. 141(R) will apply to acquisitions that are effective after December 31, 2008, and application of the standard to acquisitions prior to that date is not permitted. In the event of an acquisition, we will need to evaluate whether or not SFAS No. 141R will have a material impact on our consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, (SFAS No. 160) which provides guidance on the presentation of minority interest in the financial statements. This standard requires that minority interest be presented as a component of equity rather than as a mezzanine item between liabilities and equity, and also requires that minority interest be presented as a separate caption in the income statement. This standard also requires all transactions with minority interest holders, including the issuance and repurchase of minority interests, be accounted for as equity transactions unless a change in control of the subsidiary occurs. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. We do not believe SFAS No. 160 will have a material impact on our consolidated results of operations and financial position.

Results of Operations

Three Months Ended January 31, 2008 Compared to Three Months Ended January 31, 2007

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

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	2008	Percentage of Revenue	2007	Percentage of Revenue
North America	\$ 137,644	79%	\$ 128,925	100%
United Kingdom	35,815	21%		
	\$ 173,459	100%	\$ 128,925	100%

Revenues were approximately \$173.5 million during the three months ended January 31, 2008, an increase of approximately \$44.5 million, or 34.5% over the three months ended January 31, 2007. Revenue growth from same store sales in North America, those opened before February 1, 2007, was approximately \$8.1 million. Revenue growth from new facilities, those opened after February 1, 2007, including facilities in or near Punta Gorda, Florida; London, Ontario; Windsor, New Jersey; and Walton, Kentucky was approximately \$0.6 million. Of the increase in revenues \$35.8 million was attributable to revenues generated in the UK during the three months ended January 31, 2008 resulting from the recent acquisitions of Universal and Century both of which were not a part of the company in the three months ended January 31, 2007. Revenue in the UK was adversely affected by the acceptance of certain buyer credit card payments later determined to be fraudulent. The result was a reduction in revenue of \$0.9 million for fraudulent credit payments accepted for cars sold for our own account. We are in the process of implementing additional security technologies to mitigate the risk of credit fraud going forward. We introduced VB2 in the UK during the quarter and accepted credit card payments consistent with the prior practice in the UK. We have historically not accepted credit car payments in North America. The fraud in the UK was discovered after the end of the quarter and losses after discovery have been mitigated.

Yard Operation Expenses. Yard operation expenses were approximately \$104.9 million during the three months ended January 31, 2008, an increase of approximately \$36.3 million, or 53.0%, over the three months ended January 31, 2007. Included in yard operation expenses is depreciation expense of \$7.8 million, a decrease of \$0.08 million over the three months ended January 31, 2007. Yard operation expenses increased to 60.4% of revenues during the three months ended January 31, 2008, as compared to 53.2% of revenues during the three months ended January 31, 2007. The absolute and percentage increases in yard operation expenses, excluding depreciation, were attributable to the new UK entities Universal and Century which contributed \$35.4 million in yard operation expenses and included i) the costs of purchased cars of \$23.0 million, ii) other cost associated with the integration estimated to be approximately \$1.7 million primarily for temporary labor and contract hauling, iii) a charge of \$0.6 million for the acceptance of fraudulent buyer credit card payments for cars sold on behalf of our suppliers, and iv) direct incremental costs associated with integrating our UK operations estimated to be \$0.5 million primarily for travel and lodging for approximately 100 individuals who traveled to the UK to help staff and support the UK integration. Finally, the UK operates primarily on a principal basis, buying and reselling cars for our own account, which leads to a lower gross margin percentage.

The following sets forth information on gross margin, defined as revenue less yard operation expenses, and gross margin percentage of revenue by geographic region (in thousands, except percentages):

	2008	Gross Margin Percentage	2007	Gross Margin Percentage
North America	\$ 68,174	50%	\$ 60,389	47%
United Kingdom	434			

Revenues. The following sets forth information on customer revenue by geographic region based on the location of