

COPART INC  
Form 10-Q  
June 09, 2010  
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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 April 30, 2010**

**OR**

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**for the transition period from            to**

**Commission file number: 0-23255**

**COPART, INC.**

(Exact name of registrant as specified in its charter)

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

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

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

(Address of principal executive offices with zip code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Number of shares of the Registrant's Common Stock outstanding as of June 8, 2010: 84,336,352

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**Index to the Quarterly Report**

**April 30, 2010**

**Description**

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

|   | <b>April 30,<br/>2010</b> | <b>July 31,<br/>2009</b> |
|---|---------------------------|--------------------------|
| <b>ASSETS</b>   |                           |                          |
| Current assets:   |                           |                          |
| Cash and cash equivalents   | \$ 264,252                | \$ 162,691               |
| Accounts receivable, net  | 102,093                   | 109,248                  |
| Vehicle pooling costs   | 26,763                    | 28,685                   |
| Inventories   | 4,465                     | 4,667                    |
| Income taxes receivable   | 5,258                     | 5,426                    |
| Prepaid expenses and other assets   | 16,852                    | 5,216                    |
| Total current assets  | 419,683                   | 315,933                  |
| Property and equipment, net   | 563,364                   | 530,886                  |
| Intangibles, net  | 13,688                    | 15,212                   |
| Goodwill  | 173,778                   | 166,327                  |
| Deferred income taxes   | 13,690                    | 7,759                    |
| Other assets  | 17,803                    | 21,915                   |
| Total assets  | \$ 1,202,006              | \$ 1,058,032             |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                           |                          |
| Current liabilities:  |                           |                          |
| Accounts payable and accrued liabilities  | \$ 102,546                | \$ 82,773                |
| Deferred revenue  | 10,819                    | 13,165                   |
| Income taxes payable  | 5,910                     | 5,269                    |
| Deferred income taxes   | 1,012                     | 1,948                    |
| Other current liabilities   | 389                       | 429                      |
| Total current liabilities   | 120,676                   | 103,584                  |
| Deferred income taxes   | 9,793                     | 10,997                   |
| Income taxes payable  | 23,747                    | 20,266                   |
| Other liabilities   | 1,328                     | 1,726                    |
| Total liabilities   | 155,544                   | 136,573                  |
| Commitments and contingencies   |                           |                          |
| Shareholders' equity:   |                           |                          |
| Common stock, no par value - 180,000 shares authorized; 84,333 and 83,939 shares issued and outstanding at April 30, 2010 and July 31, 2009, respectively | 355,937                   | 334,440                  |
| Accumulated other comprehensive loss  | (35,820)                  | (27,082)                 |

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|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Retained earnings                          |    | 726,345   |    | 614,101   |
| Total shareholders' equity                 |    | 1,046,462 |    | 921,459   |
| Total liabilities and shareholders' equity | \$ | 1,202,006 | \$ | 1,058,032 |

See accompanying notes to unaudited consolidated financial statements.

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

|   | Three months ended<br>April 30, |            | Nine months ended<br>April 30, |            |
|---|---------------------------------|------------|--------------------------------|------------|
|   | 2010                            | 2009       | 2010                           | 2009       |
| <b>Net sales and revenue:</b>   |                                 |            |                                |            |
| Service revenues  | \$ 180,511                      | \$ 165,002 | \$ 483,743                     | \$ 464,012 |
| Vehicle sales   | 39,838                          | 32,324     | 98,668                         | 94,738     |
| Total service revenues and vehicle sales  | 220,349                         | 197,326    | 582,411                        | 558,750    |
| <b>Operating costs and expenses:</b>  |                                 |            |                                |            |
| Yard operations   | 88,415                          | 85,061     | 242,595                        | 245,900    |
| Cost of vehicle sales   | 31,436                          | 26,798     | 78,046                         | 80,520     |
| General and administrative  | 28,372                          | 20,587     | 79,920                         | 62,394     |
| Total operating costs and expenses  | 148,223                         | 132,446    | 400,561                        | 388,814    |
| Operating income  | 72,126                          | 64,880     | 181,850                        | 169,936    |
| <b>Other income (expense):</b>  |                                 |            |                                |            |
| Interest expense  | (38)                            | (66)       | (201)                          | (127)      |
| Interest income   | 25                              | 546        | 160                            | 1,596      |
| Other income (expense), net   | (529)                           | 536        |                                | (8)        |
| Total other income (expense)  | (542)                           | 1,016      | (41)                           | 1,461      |
| Income from continuing operations before income taxes                           | 71,584                          | 65,896     | 181,809                        | 171,397    |
| Income taxes  | 27,194                          | 25,384     | 66,415                         | 66,478     |
| Income from continuing operations   | 44,390                          | 40,512     | 115,394                        | 104,919    |
| <b>Discontinued operations:</b>   |                                 |            |                                |            |
| Income from discontinued operations, net of income tax effects                  |                                 | 1,557      |                                | 1,557      |
| Net Income  | \$ 44,390                       | \$ 42,069  | \$ 115,394                     | \$ 106,476 |
| <b>Earnings per share-basic</b>   |                                 |            |                                |            |
| Income from continuing operations   | \$ 0.53                         | \$ 0.48    | \$ 1.37                        | \$ 1.26    |
| Income from discontinued operations   |                                 | 0.02       |                                | 0.02       |
| Basic net income per share  | \$ 0.53                         | \$ 0.50    | \$ 1.37                        | \$ 1.28    |
| Weighted average common shares outstanding                                      | 84,224                          | 83,631     | 84,125                         | 83,451     |
| <b>Earnings per share-diluted</b>   |                                 |            |                                |            |
| Income from continuing operations   | \$ 0.52                         | \$ 0.48    | \$ 1.36                        | \$ 1.23    |
| Income from discontinued operations   |                                 | 0.02       |                                | 0.02       |
| Diluted net income per share  | \$ 0.52                         | \$ 0.50    | \$ 1.36                        | \$ 1.25    |
| Weighted average common shares and dilutive potential common shares outstanding | 85,148                          | 84,782     | 85,006                         | 84,953     |

See accompanying notes to unaudited consolidated financial statements.



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

|  | <b>Nine Months Ended<br/>April 30,</b> |             |
|--|--|-------------|
|  | <b>2010</b>                            | <b>2009</b> |
| <b>Cash flows from operating activities:</b>   |  |             |
| Net income   | \$ 115,394                             | \$ 106,476  |
| Adjustments to reconcile net income to net cash provided by operating activities:        |  |             |
| Income from discontinued operations  |  | (2,440)     |
| Depreciation and amortization  | 32,091                                 | 31,296      |
| Allowance for doubtful accounts  | 432                                    | (339)       |
| Other long-term liabilities  | (336)                                  | (1,028)     |
| Share-based compensation   | 13,300                                 | 1,202       |
| Excess tax benefit from share-based compensation   | (2,966)                                | (1,110)     |
| Loss on sale of property and equipment and real estate impairment                        | 2,402                                  | 720         |
| Deferred income taxes  | (7,298)                                | (1,615)     |
| Changes in operating assets and liabilities, net of effects from acquisitions:           |  |             |
| Accounts receivable  | 9,196                                  | 1,866       |
| Vehicle pooling costs  | 1,802                                  | (665)       |
| Inventories  | 164                                    | 438         |
| Prepaid expenses and other current assets  | (11,551)                               | 1,000       |
| Other assets   | 171                                    | (7,743)     |
| Accounts payable and accrued liabilities   | 17,610                                 | (6,152)     |
| Deferred revenue   | (2,348)                                | (55)        |
| Income taxes receivable  | 3,747                                  | 15,610      |
| Income taxes payable   | 2,173                                  | 17,096      |
| Net cash provided by operating activities  | 173,983                                | 154,557     |
| <b>Cash flows from investing activities:</b>   |  |             |
| Principal payments of notes receivable   |  | 12,000      |
| Purchases of property and equipment  | (59,509)                               | (69,186)    |
| Proceeds from sale of property and equipment   | 3,021                                  | 5,213       |
| Purchases of assets and liabilities in connection with acquisition, net of cash acquired | (21,366)                               | 73          |
| Net cash used in investing activities  | (77,854)                               | (51,900)    |
| <b>Cash flows from financing activities:</b>   |  |             |
| Proceeds from the exercise of stock options  | 4,094                                  | 1,200       |
| Proceeds from the issuance of Employee Stock Purchase Plan shares                        | 1,087                                  | 942         |
| Repurchase of common stock   | (3,544)                                | (6,000)     |
| Excess tax benefit from share-based payment arrangements                                 | 2,966                                  | 1,110       |
| Change in book overdraft   |  | (17,502)    |
| Net cash provided by (used in) financing activities                                      | 4,603                                  | (20,250)    |
| Effect of exchange rate changes on cash  | 829                                    | (2,398)     |
| Net increase in cash and cash equivalents  | 101,561                                | 80,009      |
| Cash and cash equivalents at beginning of period   | 162,691                                | 38,954      |



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|  |    |         |    |         |
|--|----|---------|----|---------|
| Cash and cash equivalents at end of period               | \$ | 264,252 | \$ | 118,963 |
| <b>Supplemental disclosure of cash flow information:</b> |    |         |    |         |
| Interest paid  | \$ | 201     | \$ | 126     |
| Income taxes paid  | \$ | 67,646  | \$ | 49,183  |

See accompanying notes to unaudited consolidated financial statements.

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**Copart, Inc.**

**Notes to Consolidated Financial Statements**

April 30, 2010

(Unaudited)

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

*Description of Business*

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 Second Generation Internet auction-style sales technology, which we refer to as VB2. Sellers are primarily insurance companies but also include banks and financial institutions, charities, car dealerships, fleet operators, vehicle rental companies and the general public. 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 to the extent possible. In the United States and Canada, or North America, the Company sells vehicles primarily as an agent and derives revenue primarily from fees paid by vehicle sellers and vehicle buyers as well as related fees for services such as towing and storage. In the United Kingdom, or UK, the Company operates a significant portion of our business on a principal basis, purchasing the salvage vehicle outright from the insurance company and reselling the vehicle for its own account.

*Principles of Consolidation*

The consolidated financial statements of the Company include the accounts of the parent company and its wholly-owned subsidiaries, including its foreign wholly-owned subsidiaries, Copart Canada, Inc. (Copart Canada) and Copart Europe Limited (Copart Europe) which currently operates solely in the UK. Significant intercompany transactions and balances have been eliminated in consolidation. Copart Canada was incorporated in January 2003 and Copart Europe was incorporated in June 2007.

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 April 30, 2010, and its consolidated statements of income and cash flows for the three and nine month periods ended April 30, 2010 and April 30, 2009. Interim results for the nine months ended April 30, 2010 are not necessarily indicative of the results that may be expected for any future period, nor for the entire year ending July 31, 2010. 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, 2009.

*Use of Estimates*

The preparation of financial statements in conformity with US generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used for, but not limited to,

vehicle pooling costs, self-insured reserves, allowance for doubtful accounts, income taxes, revenue recognition, share-based compensation, long-lived asset and goodwill impairment calculations and contingencies. Actual results may 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 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.

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The Company adopted the provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740-10-25, *Income Taxes*, as of August 1, 2007. For benefits to be realized, a tax position must be more likely than not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that has a greater than 50 percent likelihood of being realized upon settlement.

***Foreign Currency Translation***

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

***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 services include the ability to use the Company's 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 FASB ASC 605-25, *Revenue Recognition, Multiple Element Arrangements*, which addresses accounting for multiple-element arrangements and revenue recognition for units of accounting.

The services the Company provides to the seller of a vehicle involve disposing of the vehicle on the seller's behalf and, under most of the Company's current North American contracts, collecting the proceeds from the buyer. In these instances, 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, net of rebates and allowances.

In certain cases, seller fees are not contingent upon collection of the seller proceeds from the buyer. However, the Company has determined that it is not able to separate, in most cases, 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 those 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, when the Company purchases and remarkets vehicles on its own behalf, are recognized in accordance with FASB ASC 605-25 on the sale date, which is typically the point of high bid acceptance. Upon high bid acceptance, a legally binding contract is formed with the buyer, and the Company records the vehicle sales price, net of sales allowances, 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 FASB ASC 605-25 to determine whether the Company has met the requirements to separate the services into units of accounting within a multi-element arrangement. The Company has concluded that the sale service and the post-sale services are separate units of accounting. The fees for the auction service are recognized upon completion of the sale, and the fees for the post-sale services are recognized upon successful completion of those services using the residual method.

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

**NOTE 2 Cash, Cash Equivalents and Marketable Securities**

On August 1, 2008, the Company adopted FASB ASC 820-10, *Fair Value Measurements and Disclosures*, which clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, FASB ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level I) observable inputs such as quoted prices in active markets; (Level II) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level III) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures its investments, cash equivalents or marketable securities at fair value. Cash and cash equivalents are classified within Level I of the fair value hierarchy because they are valued using quoted market prices.

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As of April 30, 2010, cash and cash equivalents include the following (in thousands):

|                    | Cost       | Unrealized<br>Gains | Unrealized<br>Losses<br>Less Than<br>12 Months | Unrealized<br>Losses<br>12 Months or<br>Longer | Estimated Fair<br>Value |
|--------------------|------------|---------------------|--|--|-------------------------|
| Cash               | \$ 150,151 | \$                  | \$   | \$   | \$ 150,151              |
| Money market funds | 114,101    |                     |  |  | 114,101                 |
| Total              | \$ 264,252 | \$                  | \$   | \$   | \$ 264,252              |

The Company invests its excess funds in money market funds comprised of securities issued by the United States Treasury. The Company's cash and cash equivalents are placed with high credit quality financial institutions.

**NOTE 3 Vehicle Pooling Costs**

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

**NOTE 4 Net Income Per Share**

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

|  | Three Months Ended April 30,<br>2010 | Three Months Ended April 30,<br>2009 | Nine Months Ended April 30,<br>2010 | Nine Months Ended April 30,<br>2009 |
|--|--------------------------------------|--------------------------------------|-------------------------------------|-------------------------------------|
| Basic weighted average shares<br>outstanding     | 84,224                               | 83,631                               | 84,125                              | 83,451                              |
| Effect of dilutive securities - stock<br>options | 924                                  | 1,151                                | 881                                 | 1,502                               |
| Diluted weighted average shares<br>outstanding   | 85,148                               | 84,782                               | 85,006                              | 84,953                              |

Excluded from the dilutive earnings per share calculation were 6,055,784 and 5,415,077 stock options for the three months ended April 30, 2010 and April 30, 2009, respectively and 5,839,887 and 1,225,000 stock options for the nine months ended April 30, 2010 and April 30, 2009,

respectively, because their effect would have been anti-dilutive.

**NOTE 5 Discontinued Operations**

On March 10, 2009, the Company received \$12 million for the early payment of a note receivable relating to the sale of certain real estate and business assets of its discontinued operating segment, Motors Auction Group (MAG) in fiscal year 2006. Under the original terms of the note, interest only payments were due in 59 consecutive monthly installments, calculated at 7% per year, followed by one final payment due on April 28, 2011. The note was the sole consideration for the sale of real estate and the business assets. The portion of the consideration allocated to the real estate sold totaled \$7.1 million and originally resulted in a deferred gain of approximately \$1.6 million, net of taxes. The deferred gain was recognized during the three months ended April 30, 2009 upon payment of the note.



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

|                          | April 30, 2010 | July 31, 2009 |
|--------------------------|----------------|---------------|
| Amortized intangibles:   |                |               |
| Covenants not to compete | \$ 10,697      | \$ 10,697     |
| Supply contracts         | 21,828         | 20,963        |
| Software                 | 630            | 712           |
| Licenses and databases   | 1,309          | 1,322         |
| Accumulated amortization | (20,776)       | (18,482)      |
| Net intangibles          | \$ 13,688      | \$ 15,212     |

Aggregate amortization expense on amortizable intangible assets was \$1.0 million and \$0.9 million for the three months ended April 30, 2010 and 2009, respectively and \$3.0 million for the nine months ended April 30, 2010 and 2009.

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

|   |            |
|---|------------|
| Balance as of July 31, 2009               | \$ 166,327 |
| Goodwill recorded during the period       | 12,026     |
| Effect of foreign currency exchange rates | (4,575)    |
| Balance as of April 30, 2010              | \$ 173,778 |

**NOTE 7 Share-Based Compensation**

Effective August 1, 2005, the Company adopted the provisions of FASB ASC 718, *Compensation - Stock Compensation*, 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 FASB ASC 718. Under this method, share-based compensation expense for the three- and nine-month periods ended April 30, 2010 and April 30, 2009 includes 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 FASB ASC 718 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 FASB ASC 718. 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 options during fiscal 2010:

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|                               | Shares<br>(in 000 s) | Weighted-<br>average<br>Exercise Price | Weighted-average<br>Remaining<br>Contractual Term | Aggregate<br>Intrinsic Value<br>(in 000 s) |
|-------------------------------|----------------------|--|---|--|
| Outstanding at July 31, 2009  | 8,005                | \$ 26.97                               |   |  |
| Grants of options             | 948                  | \$ 33.47                               |   |  |
| Exercises                     | (505)                | \$ 15.50                               |   |  |
| Forfeitures or expirations    | (25)                 | \$ 26.33                               |   |  |
| Outstanding at April 30, 2010 | 8,423                | \$ 28.40                               | 7.50  | \$ 62,493                                  |
| Exercisable at April 30, 2010 | 3,477                | \$ 24.08                               | 5.64  | \$ 40,823                                  |

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 7,963,054 options that were in-the-money at April 30, 2010.

In April 2009, the Compensation Committee of the Company's Board of Directors, following shareholder approval of proposed grants at a special meeting of shareholders, approved the grant to each of Willis J. Johnson, the Company's Chairman (and then Chief Executive Officer), and A. Jayson Adair, the Company's Chief Executive Officer (and then President), of nonqualified stock options to purchase 2,000,000 shares of the Company's common stock at an exercise price of \$30.21 per share, which equaled

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the closing price of the Company's common stock on April 14, 2009, 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 the executive, with twenty percent (20%) vesting on April 14, 2010, and the balance vesting monthly over the subsequent four years. Each option will become fully vested, assuming continued service, on April 14, 2014, the fifth anniversary of the date of grant. If, prior to a change in control, either executive's employment is terminated without cause, then one hundred percent (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 one hundred percent (100%) of the shares subject to his stock option will immediately vest. The value of each option at the date of grant was \$13.04. The total estimated compensation expense to be recognized by the Company over the five year estimated service period is approximately \$26.1 million per grant.

On February 12, 2010 Mr. Willis J. Johnson resigned as Chief Executive Officer. He will continue to serve as Chairman of the Board and will remain an executive officer of the Company. In addition, Mr. A. Jayson Adair, previously Copart's President was appointed Copart's Chief Executive Officer and, Mr. Vincent W. Mitz, previously Copart's Executive Vice President was appointed as Copart's new President.

**NOTE 8 Common Stock Repurchases**

In October 2007, the Company's Board of Directors approved a 20 million share increase in the Company's stock repurchase program, bringing the total current number of shares authorized for repurchase to 29 million shares. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. Subject to applicable securities laws, such repurchases will be made at such times and in such amounts as the Company deems appropriate and may be discontinued at any time. The Company did not repurchase any shares during the nine months ended April 30, 2010 or April 30, 2009. The total number of shares repurchased under the program as of April 30, 2010 was approximately 14 million, leaving approximately 15 million available for repurchase by the Company under the repurchase program.

In the second and fourth quarters of fiscal year 2009 and the first quarter of fiscal year 2010, Mr. Adair exercised stock options through cashless exercises. A portion of the options exercised were net settled in satisfaction of the exercise price and federal and state minimum statutory tax withholding requirements. The company remitted approximately \$13.3 million to the proper taxing authorities in satisfaction of the employee's minimum statutory withholding requirements. The exercises are summarized in the following table:

| Period     | Options exercised | Exercise price | Shares net settled for exercise | Shares withheld for taxes (1) | Share price for withholding | Tax withholding (in 000s) |
|------------|-------------------|----------------|---------------------------------|-------------------------------|-----------------------------|---------------------------|
| FY 2009 Q2 | 600,000           | \$ 4.47        | 96,929                          | 222,817                       | \$ 26.93                    | \$ 6,000                  |
| FY 2009 Q4 | 361,035           | \$ 11.12       | 116,741                         | 109,595                       | \$ 34.39                    | \$ 3,769                  |
| FY 2010 Q1 | 323,631           | \$ 13.03       | 114,354                         | 95,746                        | \$ 36.89                    | \$ 3,532                  |

(1) 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 Segments and Other Geographic Reporting**

The Company's North American region and its United Kingdom region are considered two separate operating segments, which have been aggregated into one reportable segment because they share similar economic characteristics.

Table of Contents**NOTE 10 Comprehensive Income**

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

|  | Three Months Ended April 30, |           | Nine Months Ended April 30, |            |
|--|------------------------------|-----------|-----------------------------|------------|
|  | 2010                         | 2009      | 2010                        | 2009       |
| Net income, as reported                                      | \$ 44,390                    | \$ 42,069 | \$ 115,394                  | \$ 106,476 |
| Other comprehensive loss:                                    |                              |           |                             |            |
| Foreign currency translation adjustments, net of tax effects | (5,881)                      | 3,354     | (8,738)                     | (42,214)   |
| Total other comprehensive income                             | \$ 38,509                    | \$ 45,423 | \$ 106,656                  | \$ 64,262  |

**NOTE 11 Recent Accounting Pronouncements**

FASB ASC 820, *Fair Value Measurements and Disclosures*, which was effective for the Company in the first quarter ended October 31, 2009. The Company adopted FASB ASC 820 for its non-financial assets and non-financial liabilities, which include assets and liabilities acquired in connection with business combinations and intangible assets. The adoption of FASB ASC 820 for non-financial assets and liabilities did not have an impact on the Company's consolidated results of operations or financial condition.

FASB ASC 810, *Consolidation*, which was effective for the Company in the first quarter ended October 31, 2009, provides guidance on the presentation of minority interests in the financial statements. This standard requires that minority interest be presented as a component of equity rather than as a mezzanine item between liabilities and equity, and also requires that minority interests be presented as a separate caption in the income statement. This standard also requires all transactions with minority interest holders, including the issuance and repurchase of minority interests, be accounted for as equity transactions unless a change in control of the subsidiary occurs. The adoption of FASB ASC 810 did not have an impact on the Company's consolidated results of operations or financial position.

FASB ASC 815-10-50, *Derivatives and Hedging*, which was effective for the Company in the first quarter ended October 31, 2009, requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under FASB ASC 815-10-50, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. FASB ASC 815-10-50 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under FASB ASC 815-10-50. The adoption of FASB ASC 815-10-50 did not have an impact on the Company's consolidated results of operations or financial position.

FASB ASC 350-30-35, *Intangibles - Goodwill and other*, which was effective for the Company in the first quarter ended October 31, 2009, amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The adoption of FASB ASC 350-30-35 did not have an impact on the Company's consolidated results of operations or financial position.

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FASB ASC 810-15-13, *Consolidation - Variable Interest Entities*, which was effective for the Company in the first quarter ended October, 31, 2009, requires an enterprise to perform an analysis:

- to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity;
- to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity;
- to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity;
- to add an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance; and
- to require enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a variable interest entity.

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The adoption of FASB ASC 810-15-13 did not have an impact on the Company's consolidated results of operations or financial position.

In June 2009, the FASB established the FASB Accounting Standards Codification (Codification) which was effective for the Company in the first quarter ended October 31, 2009. The codification became the single official source of authoritative US GAAP (other than guidance issued by the SEC), superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related literature. After that date, only one level of authoritative US GAAP exists. All other literature is considered non-authoritative.

**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 matter:

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

The Company provides for costs relating to these matters when a loss is probable and the amount can be reasonably estimated. When a range of outcomes can be identified the Company will recognize an expense in the financials in an amount equal to the lower end of the range. The effect of the outcome of these matters on our future results of operations cannot be predicted because any such effect depends on future results of operations 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 our financial position, results of operations or cash flows. However, the amount of the liabilities associated with these claims, if any, cannot be determined with certainty. The Company maintains insurance which may or may not provide coverage for claims made against us. There is no assurance that the Company will have insurance coverage available when and if needed. Additionally, the insurance that the Company carries requires that the Company pay for costs or claims exposure up to the amount of the insurance deductibles negotiated when insurance is purchased.

**NOTE 13 Income Taxes**

The Company adopted the provisions of FASB ASC 740-10-25, *Income Taxes*, as of August 1, 2007. For benefits to be realized, a tax position must be more likely than not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement.

As of April 30, 2010, the total gross unrecognized tax benefits increased from July 31, 2009 by approximately \$3.5 million to \$23.7 million, including interest and penalty.

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As of April 30, 2010, the gross amounts of the Company's liabilities for unrecognized tax benefits were classified as long term income taxes payable and as long term receivables, respectively, in the accompanying consolidated balance sheet. 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 recognized interest and penalties related to uncertain tax positions in income tax expense. The amount of interest and penalties accrued as of April 30, 2010 was approximately \$1.1 million.

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

The Company has not provided US federal income and foreign withholding taxes from undistributed earnings of its foreign operations, including Copart Europe, because it plans to permanently reinvest the earnings of its foreign operations as of April 30, 2010. If these earnings were distributed, foreign tax credits may become available under current law to reduce or eliminate the resultant US income tax liability.



Table of Contents**NOTE 14 Credit Facility**

On March 6, 2008, the Company entered into an unsecured credit agreement with Bank of America, N.A. (the Credit Agreement) providing for a \$200 million revolving credit facility (the Credit Facility). Currently available under the Credit Agreement is \$150 million, subject to a \$100 million foreign currency borrowing sublimit and a \$50 million letter of credit sublimit. Amounts borrowed under the Credit Facility may be used for repurchases of stock, capital expenditures, working capital and other general corporate purposes. The Credit Facility matures and all outstanding borrowings are due on the fifth anniversary of the Credit Agreement (the Maturity Date), with annual reductions in availability of \$25 million on each of the first three anniversaries of the Credit Agreement. Amounts borrowed under the Credit Facility may be repaid and re-borrowed until the Maturity Date and bear interest, at the Company's option, at either Eurocurrency Rate plus 0.5% to 0.875%, depending on the leverage ratio, as defined in the Credit Agreement, at the end of the previous quarter or at the U.S. 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. The Credit Facility contains restrictions with respect to investments, mergers and acquisitions, dividends and distributions and redemptions of capital stock, these restrictions become effective only after the Company's debt to EBITDA ratio exceeds 1.0:1.0. At April 30, 2010, the debt to EBITDA ratio was less than 1.0:1.0. As of April 30, 2010 and July 31, 2009, the Company did not have an outstanding balance under the Credit Facility.

**NOTE 15 Acquisitions**

In January 2010, the Company completed the purchase of the assets and business of D Hales Limited ( D Hales ) which operated five locations in the United Kingdom. This acquisition was undertaken because of its strategic fit with the United Kingdom business and has been accounted for using the purchase method in accordance with FASB ASC 805, *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 D Hales 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 FASB ASC 805, D Hales' assets acquired and liabilities assumed have been recorded at their estimated fair values. The Company has not finalized the valuations of purchased assets, however 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.

**NOTE 16 Reclassifications**

The Company made certain reclassifications to conform to current year presentation. The Company reclassified \$66,000 and \$127,000 of interest expense for the three and nine months ended April 30, 2009, respectively, from Interest income, net.

**NOTE 17 Subsequent Events**

None.

**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 Quarterly Report on 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*

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*reliance upon the safe harbor provision of the Private Securities Litigation Reform Act of 1995. These factors include those listed in Part I, Item 1A. Risk Factors of this 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, or SEC. The Company may from time to time make additional written and oral forward-looking statements, including statements contained in the Company's filings with the SEC. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.*

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

**Overview**



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

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

Operating costs consist primarily of operations 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. 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.

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

### **Acquisitions and New Operations**

We have experienced growth as we have established or acquired eleven new facilities since the beginning of fiscal 2009.

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 strengthen our coverage as we have 152 facilities located in North America and the United Kingdom and are able to provide national coverage for our sellers.

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The following table sets forth facilities that we have acquired or opened from August 1, 2008 through April 30, 2010:

| Salvage Locations     | Acquisition or Greenfield | Date            | Geographic Service Area               |
|-----------------------|---------------------------|-----------------|---------------------------------------|
| Louisville, Kentucky  | Greenfield                | September 2008  | Western Kentucky and Southern Indiana |
| Richmond, Virginia    | Greenfield                | * October 2008  | Central Virginia                      |
| Montgomery, Alabama   | Greenfield                | February 2009   | Central Alabama                       |
| Greer, South Carolina | Greenfield                | February 2009   | Northwest South Carolina              |
| Warren, Massachusetts | Greenfield                | June 2009       | Central Massachusetts                 |
| Bristol               | Acquisition               | January 2010    | United Kingdom                        |
| Bedford               | Acquisition               | January 2010    | United Kingdom                        |
| Colchester            | Acquisition               | January 2010    | United Kingdom                        |
| Gainsborough          | Acquisition               | ** January 2010 | United Kingdom                        |
| Luton                 | Acquisition               | January 2010    | United Kingdom                        |
| Scranton              | Greenfield                | February 2010   | Pennsylvania                          |

\* Former Motors Auction Group facility

\*\* Closed during third quarter of fiscal year 2010

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, we have certain contracts we acquired as a result of our UK acquisitions that require us to act as a principal, purchasing vehicles from the insurance companies and reselling them for our own account. It is our intention, where possible, to continue the process of migrating these contracts to the agency model in future periods. Changes in the amount of revenue derived in a period from principal based transactions relative to total revenue will impact revenue growth and margin percentages.

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

### Critical Accounting Policies and Estimates



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

Management has discussed the selection of critical accounting policies and estimates with the Audit Committee of the Board of Directors and the Audit Committee has reviewed our disclosure relating to critical accounting policies and estimates in this Quarterly Report on Form 10-Q. The following is a summary of the more significant judgments and estimates included in our critical accounting policies used in the preparation of our consolidated financial statements. Where appropriate, we discuss sensitivity to change based on other outcomes reasonably likely to occur.

### **Revenue Recognition**

We provide a portfolio of services to our sellers and buyers that facilitate the sale and delivery of a vehicle from seller to buyer. These services include the ability to use our Internet sales technology and vehicle delivery, loading, title processing, preparation and storage. We evaluate multiple-element arrangements relative to our buyer and seller agreements in accordance with FASB ASC 605, *Revenue Recognition*, which addresses accounting for multiple-element arrangements and revenue recognition for units of accounting.

The services we provide to the seller of a vehicle involve disposing of the vehicle on the seller's behalf and, under most of our current North American contracts, collecting the proceeds from the buyer. In these instances, we are not entitled to any 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, net of rebates and allowances.



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Vehicle sales, where we purchase and remarket vehicles on our own behalf, are recognized in accordance with FASB ASC 605 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, in most cases, 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 those 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 FASB ASC 605 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 a registration fee for the right to participate in our vehicle sales program, which is usually recognized ratably over the term of the arrangement, and relist and late-payment fees, which are recognized upon receipt of payment by the buyer. No provision for returns has been established, as all sales are final with no right of return, although we provide for bad debt expense in the case of non-performance by our buyers or sellers.

**Vehicle Pooling Costs**



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

We apply the provisions of FASB ASC 330-10-35, *Inventory Subsequent Measurement*, to our vehicle pooling costs. FASB ASC 330-10-35 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 FASB ASC 330-10-35. In addition the guidance requires that the allocation of fixed production overhead 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 sellers or buyers and the inability of our sellers or buyers to make required payments. If billing disputes exceed expectations and/or if the financial condition of our sellers or buyers were to deteriorate, additional allowances may be required. The allowance is calculated by taking both seller and buyer accounts receivables written off during the previous 12 month period as a percentage of the total accounts receivable balance, i.e. total write-offs/total accounts receivable (write-off percentage). We note that a one percentage-point deviation in the write-off percentage would have resulted in an increase or decrease to the allowance for doubtful accounts balance of less than \$0.1 million for the three months ended April 30, 2010.

### **Valuation of Goodwill**

We evaluate the impairment of goodwill of our North American and UK operating segments 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.

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**Income Taxes and Deferred Tax Assets**

We account for income taxes in accordance with FASB ASC 740, *Income Taxes*. We are subject to income taxes in the US, Canada and the UK. In arriving at a provision of income taxes, we first calculate taxes payable in accordance with the prevailing tax laws in the jurisdictions in which we operate. We then analyze the timing differences between the financial reporting and tax basis of our assets and liabilities, such as various accruals, depreciation and amortization. The tax effects of the timing difference are presented as deferred tax assets and liabilities in the consolidated balance sheet. We assess the probability that the deferred tax assets will be realized based on our ability to generate future taxable income. In the event that it is more likely than not the full benefit would not be realized from the deferred tax assets we carry on our consolidated balance sheet, we record a valuation allowance to reduce the carrying value of the deferred tax assets to the amount expected to be realized. As of April 30, 2010, we had approximately \$0.3 million of valuation allowance arising from the net operating losses in states where we had discontinued certain operations in prior years. To the extent we establish a valuation allowance or change the amount of valuation allowance in a period, we reflect the change with a corresponding increase or decrease in our income tax provision in the consolidated income statement.

Historically, our provision for income taxes have been sufficiently provided to cover our actual income tax liabilities among the jurisdictions in which we operate. Nonetheless, our future effective tax rate could still be adversely affected by the following factors, including (i) the geographical allocation of our future earnings, (ii) changes in tax laws or our interpretation of tax laws, (iii) the changes in governing regulations and accounting principles, (iv) the changes in the valuation of our deferred tax assets and liabilities and (v) the outcome of the income tax examinations. As a result, we routinely assess the possibilities of material changes resulting from the aforementioned factors to determine the adequacy of our income tax provision.

Based on our results for the nine months ended April 30, 2010, a one percentage-point change in our provision for income taxes as a percentage of income before taxes would have resulted in an increase or decrease in the provision of approximately \$1.8 million.

Effective August 1, 2007, we adopted FASB ASC 740-10-25, *Income Taxes*, which contains a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest settlement of any particular position, could require the use of cash. In addition, we are subject to the continuous examination of our income tax returns by various taxing authorities, including Her Majesty's Revenue and Customs in the UK, the Internal Revenue Service and U.S. state tax agencies. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

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



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



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**Stock-Based Compensation**

We account for our stock-based awards to employees and non-employees using the fair value method as required by FASB ASC 718, *Compensation - Stock Compensation*. FASB ASC 718 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 insurance policies are generally subject to a \$250,000 deductible per claim, with the exception of our medical policy which is \$150,000 per claim. In addition, each of our policies contains an aggregate stop loss which limits our ultimate exposure. 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. The primary estimates used in the actuarial analysis include total payroll and revenue. Our estimates have not materially fluctuated from actual results. 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 consolidated financial position, results of operations or cash flows could be impacted. The process of determining our insurance reserves requires estimates with various assumptions, each of which can positively or negatively impact those balances. The total amount reserved for all policies is approximately \$6.4 million as of April 30, 2010. If the total number of participants in the medical plan changed by 10% we estimate that our medical expense would change by approximately \$0.8 million and our medical accrual would change by approximately \$200,000. If our total payroll changed by 10% we estimate that our workers' compensation expense would change by approximately \$100,000 and our accrual for workers' compensation expenses would change by \$100,000. A 10% change in revenue would change our insurance premium for the general liability and umbrella policy by less than \$20,000.

### **Segment Reporting**

Our North American and United Kingdom regions are considered two separate operating segments, which have been aggregated into one reportable segment because they share similar economic characteristics.

### **Recently Issued Accounting Standards**



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The information set forth above under Note 11 – Recent Accounting Pronouncements contained in the Notes to Consolidated Financial Statements is incorporated herein by reference.

### **Results of Operations**



## Three Months Ended April 30, 2010 Compared to Three Months Ended April 30, 2009

**Revenues.** The following sets forth revenue by class of revenue (in thousands, except percentages):

|                  | 2010 |         | Percentage of<br>Revenue | 2009 |         | Percentage of<br>Revenue |
|------------------|------|---------|--------------------------|------|---------|--------------------------|
| Service revenues | \$   | 180,511 | 82%                      | \$   | 165,002 | 84%                      |
| Vehicle sales    |      | 39,838  | 18%                      |      | 32,324  | 16%                      |
|                  | \$   | 220,349 | 100%                     | \$   | 197,326 | 100%                     |

**Service Revenues.** Service revenues were approximately \$180.5 million during the three months ended April 30, 2010 compared to \$165.0 million for the same period last year, an increase of \$15.5 million or 9.4%. The increase in service revenue was due primarily to an increase in the average revenue per car sold. The increase in the revenue per car sold was driven by increased auction prices as over 50% of our service revenue is tied in some manner to the ultimate selling price of the vehicle at the auction. We believe the increase in the average selling price was primarily due to: (i) an increase in commodity pricing, particularly the per ton price for crushed car bodies which has an impact on the ultimate selling price of vehicles sold for scrap and vehicles sold for dismantling and (ii) the general increase in used car pricing, which has an impact on the average selling price of vehicles that are either repaired and retailed or purchased by the end user. We do not, however, have sufficient information to determine the movement

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of these influences nor can we determine which vehicles are sold directly to the end user or for scrap, dismantling, retailing, or export and, accordingly, cannot quantify the specific impact that commodity pricing and used car pricing had on the selling price of vehicles. The average USD to GBP exchange rate was 1.53 dollars to the pound and 1.44 dollars to the pound for the three months ended April 30, 2010 and 2009, respectively, and resulted in an increase in service revenue of \$0.9 million. Unit volume was relatively flat.

**Vehicle Sales.** Vehicle sales revenues were approximately \$39.8 million during the three months ended April 30, 2010 compared to \$32.3 million for the same period last year, an increase of \$7.5 million, or 23.2%. The increase in vehicle sales revenue was due to (i) an increase in the average selling price of vehicles and (ii) the positive impact on recorded vehicle sales revenue due to the change in the GBP to USD exchange which increased revenue by \$11.1 million and \$2.1 million, respectively. The increase in the average selling price per unit resulted in an increase in revenue of \$11.1 million and was primarily due to: (i) the increase in commodity pricing, particularly the per ton price for crushed car bodies which has an impact on the ultimate selling price of vehicles sold for scrap and vehicles sold for dismantling (ii) the general increase in used car pricing which has an impact on the average selling price of vehicles that are either repaired and retailed or purchased by the end user and (iii) the continuing beneficial impact of VB2, our internet selling platform which we introduced to the UK in 2008 and which expands our buyer base by opening vehicle sales to buyers worldwide. We do not, however, have sufficient information to determine the movement in these influences nor can we determine which vehicles are sold directly to the end user or for scrap, dismantling, retailing, or export and, accordingly, cannot quantify the specific impact that commodity pricing, used car pricing and the impact of VB2 had on the selling price of vehicles. Volume declined primarily due to the migration of certain contracts in the UK from the principal model to the agency model and resulted in a reduction in vehicle sales revenue of \$8.9 million.

**Yard Operation Expenses.** Yard operation expenses, excluding depreciation and amortization, were approximately \$79.6 million during the three months ended April 30, 2010 compared to \$77.0 million for the same period last year, an increase of approximately \$2.6 million, or 3.4%. Included in the yard operations expense for the current quarter is the impairment of certain real estate in the UK totaling \$1.6 million. Other increases were driven by the opening or acquisition of 7 new yards in the last twelve months and the negative impact of the change in GBP to USD exchange rate of \$0.7 million.

Operation depreciation and amortization expenses were \$8.8 million and \$8.1 million for the three months ended April 30, 2010 and 2009, respectively.

**Cost of Vehicle Sales.** The cost of vehicle sales were approximately \$31.4 million during the three months ended April 30, 2010 compared to \$26.8 million for the same period last year, an increase of approximately \$4.6 million, or 17.3%. The growth was primarily due to an increase in the average cost per vehicle sold and the negative impact due to the change in the GBP to USD, which totaled \$7.4 and \$1.6 million, respectively. Unit volume declined due primarily to the migration of certain contracts in the UK from a principal basis to a fee basis and reduced cost of vehicles sold by \$4.3 million.

**General and Administrative Expenses.** General and administrative expenses, excluding depreciation and amortization, were approximately \$26.3 million for the three months ended April 30, 2010 compared to \$18.5 million for the same period last year, an increase of approximately \$7.9 million, or 42.6%. The growth in general and administrative costs was primarily due to: (i) increased advertising costs as we invested in events and media promotions to generate new member activity and (ii) the additional costs associated with the Chairman and Chief Executive Officer's non-cash compensation package approved by the shareholders in April 2009.

General and administrative depreciation and amortization expenses were \$2.0 million and \$2.1 million for the three months ended April 30, 2010 and 2009, respectively.



**Other Income (Expense).** Total other expense was approximately \$0.5 million during the three months ended April 30, 2010 compared to income of \$1.0 million for the same period last year, a change of approximately \$1.5 million. Included in other expense was a loss from the sale of an airplane of \$0.8 million. Net interest income (expense) declined \$0.5 million due primarily to reductions in interest yield.

**Income Taxes.** Our effective income tax rates for the three months ended April 30, 2010 and 2009 were approximately 38.0% and 38.5%, respectively. The decrease was driven primarily by the geographical mix of earnings including better results in the UK whose statutory income tax rate is lower than that of the U.S.

**Net Income.** Due to the foregoing factors, we realized net income of approximately \$44.4 million for the three months ended April 30, 2010, compared to net income of approximately \$42.1 million for the same period last year.

Table of Contents**Nine Months Ended April 30, 2010 Compared to Nine Months Ended April 30, 2009**

**Revenues.** The following sets forth revenue by class of revenue (in thousands, except percentages):

|                  | 2010 |         | Percentage of Revenue | 2009 |         | Percentage of Revenue |
|------------------|------|---------|-----------------------|------|---------|-----------------------|
| Service revenues | \$   | 483,743 | 83%                   | \$   | 464,012 | 83%                   |
| Vehicle sales    |      | 98,668  | 17%                   |      | 94,738  | 17%                   |
|                  | \$   | 582,411 | 100%                  | \$   | 558,750 | 100%                  |

**Service Revenues.** Service revenues were approximately \$483.7 million during the nine months ended April 30, 2010 compared to \$464.0 million for the same period last year, an increase of \$19.7 million or 4.3%. The increase in service revenue was due to (i) an increase in the volume of units sold, (ii) an increase in average revenue per unit and (iii) a beneficial impact of the change in the dollar to pound exchange rate which increased service revenues by \$2.0 million, \$16.9 million and \$0.8 million, respectively. The increase in volume was due primarily to the migration of certain contracts in the U.K. from the principal model to the agency model offset by volume decreases in North America. The increase in the average selling price per unit resulted in an increase in revenue per car sold and was primarily due to: (i) the increase in commodity pricing, particularly the per ton price for crushed car bodies which has an impact on the ultimate selling price of vehicles sold for scrap and vehicles sold for dismantling (ii) the general increase in used car pricing which has an impact on the average selling price of vehicles that are either repaired and retailed or purchased by the end user and (iii) the continuing beneficial impact of VB2, our internet selling platform which we introduced to the UK in 2008 and which expands our buyer base by opening vehicles sales to buyers worldwide. We do not, however, have sufficient information to determine the movement in these influences nor can we determine which vehicles are sold directly to the end user or for scrap, dismantling, retailing, or export and, accordingly, cannot quantify the specific impact that commodity pricing, used car pricing and the impact of VB2 had on the selling price of vehicles.

**Vehicle Sales.** Vehicle sales revenues were approximately \$98.7 million during the nine months ended April, 2010 compared to \$94.7 million for the same period last year, an increase of \$3.9 million, or 4.1%. The increase in vehicle sales revenue was due to (i) an increase in the average selling price per unit and (ii) the positive impact on recorded vehicle sales revenue due to the change in the GBP to USD exchange rate and was offset by (iii) the reduced unit volume processed. The increase in the average sales price per car sold which resulted in an increase of revenue of \$19.1 million was primarily due to: (i) the increase in commodity pricing, particularly the per ton price for crushed car bodies, has an impact on the ultimate selling price of vehicles sold for scrap and vehicles sold for dismantling (ii) the general increase in used car pricing, which has an impact on the average selling price of vehicles that are either repaired and retailed or purchased by the end user and (iii) the continuing beneficial impact of VB2, our internet selling platform which we introduced to the UK in 2008 and which expands our buyer base by opening vehicles sales to buyers worldwide. We do not, however, have sufficient information to determine the movement in these influences in the UK market nor can we determine which vehicles are sold to the end user or for scrap, dismantling, retailing, or export and, accordingly, cannot quantify the specific impact that commodity pricing, used car pricing and the impact of VB2 had on the selling price of vehicles. The beneficial impact of the average USD to GBP exchange rate lead to an increase in vehicle sales revenue of \$1.5 million. Volume declined due primarily to the migration of certain contracts in the UK from the principal model to an agency model and resulted in a reduction in revenue of \$16.6 million.

**Yard Operation Expenses.** Yard operation expenses, excluding depreciation and amortization, were approximately \$216.8 million during the nine months ended April 30, 2010 compared to \$221.5 million for the same period last year, a decline of approximately \$4.7 million, or 2.1%. The decline was driven primarily by operational efficiencies and by reductions in subhauling costs relative to the first two quarters of fiscal 2009 when the cost of diesel fuel peaked.

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Operation depreciation and amortization expenses were \$25.8 million and \$24.4 million for the nine months ended April 30, 2010 and 2009, respectively.

**Cost of Vehicle Sales.** The cost of vehicle sales were approximately \$78.0 million during the nine months ended April 30, 2010 compared to \$80.5 million for the same period last year, a decline of approximately \$2.5 million, or 3.1%. Unit volume decline lead to a reduction of \$13.4 million and was due primarily to the migration of certain contracts in the UK from a principal basis to a fee basis. Cost per unit sold was up and represented a \$9.7 million increase relative to last year. The negative impact on the cost of sales due to the change in the GBP to USD exchange rate was \$1.2 million.

**General and Administrative Expenses.** General and administrative expenses, excluding depreciation and amortization, were approximately \$73.6 million for the nine months ended April 30, 2010 compared to \$55.5 million for the same period last year, an increase of approximately \$18.1 million, or 32.6%. The growth in general and administrative costs was due primarily to: (i) increased advertising costs as we invested in events and media promotions to generate new member activity (ii) the additional

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costs associated with the Chairman and Chief Executive Officer's non-cash compensation package approved by the shareholders in April 2009 and (iii) increased headcount associated with software development. These changes increased general and administrative expenses by \$6.4 million, \$6.1 million, and \$2.4 million, respectively.

General and administrative depreciation and amortization expenses were \$6.3 million and \$6.9 million for the nine months ended April 30, 2010 and 2009, respectively.

**Other Income (Expense).** Total other expense was less than \$0.1 million during the nine months ended April 30, 2010 compared to income of \$1.5 million for the same period last year, a change of approximately \$1.5 million. Included in other expense was the loss on the sale of an airplane of \$0.8 million. Net interest income (expense) declined \$1.5 million due primarily to reductions in interest yield.

**Income Taxes.** Our effective income tax rates for the nine months ended April 30, 2010 and 2009 were approximately 36.5% and 38.8%, respectively. The decrease was driven primarily by an agreement that we had reached with Her Royal Majesty's Revenue and Customs during Q2 of fiscal 2010. This agreement permitted us to deduct the interest expense on intercompany debt for UK income tax purposes from fiscal years 2008, 2009 and 2010.

**Net Income.** Due to the foregoing factors, we realized net income of approximately \$115.4 million for the nine months ended April 30, 2010, compared to net income of approximately \$106.5 million for the same period last year.

**Liquidity and Capital Resources**

Our primary source of working capital is cash generated through operations. Potential internal sources of additional working capital are the sale of assets or the issuance of equity through option exercises and shares issued under our 1994 Employee Stock Purchase Plan. A potential external source of additional working capital is the issuance of debt and equity. However, with respect to the issuance of equity or debt, we cannot predict if these sources will be available in the future and if available, if they can be issued under terms commercially acceptable to us.

Historically, we have financed our growth through cash generated from operations, public offerings of common stock, the equity issued in conjunction with certain acquisitions and debt financing. Our primary source of cash generated by operations is from the collection of sellers fees, buyers fees and reimbursable advances from the proceeds of vehicle sales. Our business is seasonal as inclement weather during the winter months increases the frequency of accidents and, consequently, the number of cars deemed as totaled by the insurance companies. 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.

Because our primary source of working capital is net income, factors affecting net income are the principal factors affecting the generation of working capital. Those primary factors: (i) seasonality, (ii) market wins and losses, (iii) supplier mix, (iv) accident frequency, (v) salvage frequency, (vi) change in market share of our existing suppliers, (vii) commodity pricing, (viii) used car pricing, (ix) foreign currency exchanges rates, (x) product mix, and (xi) contract mix to the extent appropriate, are discussed in the Results of Operations and Risk Factors sections of this

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Quarterly Report on Form 10-Q.

As of April 30, 2010, we had working capital of approximately \$299.0 million, including cash and cash equivalents of approximately \$264.3 million. Cash equivalents consisted primarily of funds invested in money market accounts, which bear interest at a variable rate. Cash and cash equivalents increased by approximately \$101.6 million from July 31, 2009 to April 30, 2010.

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

### *Operating Activities*



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Net cash provided by operating activities increased by approximately \$19.4 million to \$174.0 million during the nine months ended April 30, 2010 when compared to the nine months ended April 30, 2009, due to the timing of routine changes in working capital items.

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*Investing Activities*

Capital expenditures (excluding those associated with fixed assets attributable to acquisitions) were approximately \$59.5 million and \$69.2 million for the nine months ended April 30, 2010 and 2009, respectively. Our capital expenditures are related primarily to opening and improving facilities and acquiring yard equipment. We continue to expand and invest in new and existing facilities and standardize the appearance of existing locations. We have no material commitments for future capital expenditures as of April 30, 2010.

*Financing Activities*





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For the nine months ended April 30, 2010 and 2009, we generated approximately \$8.1 million and \$3.3 million, respectively, through the exercise of stock options, including the related excess tax benefit from share-based payment arrangements and shares issued under our 1994 Employee Stock Purchase Plan. In addition, we repurchased shares for approximately \$3.5 million and \$6.0 million during the nine months ended April 30, 2010 and 2009, respectively, in connection with net settled option exercises. These shares were treated as a repurchase of shares for accounting purposes, but do not count against our stock repurchase program approved by the Board of Directors.

In October 2007, our Board of Directors approved a 20 million share increase in our stock repurchase program, bringing the total current authorization to 29 million shares. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. Subject to applicable securities laws, such repurchases will be made at such times and in such amounts as we deem appropriate and may be discontinued at any time. We did not repurchase any shares during the nine months ended April 30, 2010 and 2009. The total number of shares repurchased under the program as of April 30, 2010 was approximately 14 million, leaving approximately 15 million available for repurchase by us under the repurchase program.

### *Credit Facility*

On March 6, 2008, we entered into an unsecured credit agreement with Bank of America, N.A. (the Credit Agreement) providing for a \$200 million revolving credit facility (the Credit Facility). Currently available under the Credit Agreement is \$150 million, subject to, a \$100 million foreign currency borrowing sublimit and a \$50 million letter of credit sublimit. Amounts borrowed under the Credit Facility may be used for repurchases of stock, capital expenditures, working capital and other general corporate purposes. The Credit Facility matures, and all outstanding borrowings are due, on the fifth anniversary of the Credit Agreement, with annual reductions in availability of \$25 million on each of the first three anniversaries of the Credit Agreement. Amounts borrowed under the Credit Facility may be repaid and re-borrowed until the maturity date and bear interest, at our option, at either Eurocurrency Rate plus 0.5% to 0.875%, depending on the leverage ratio, as defined in the Credit Agreement, at the end of the previous quarter or at the U.S. prime rate. A default interest rate applies on all obligations during an event of default under the Credit Facility at a rate per annum equal to 2.0% above the otherwise applicable interest rate. The Credit Facility requires us to pay a commitment fee on the unused portion of the Credit Facility. The commitment fee ranges from 0.075% to 0.15% depending on the leverage ratio as of the end on the previous quarter. The Credit Facility contains customary representations and warranties and places certain business operating restrictions on us relating to, among other things, indebtedness, liens and other encumbrances, investments, mergers and acquisitions, asset sales, and dividends, distributions and redemptions of capital stock. In addition, the Credit Agreement provides for a maximum total leverage ratio and a minimum interest coverage ratio. The Credit Facility contains events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, cross-defaults to certain other indebtedness, bankruptcy and insolvency defaults, material judgments, invalidity of the loan documents and events constituting a change of control. The Credit Facility is guaranteed by our material domestic subsidiaries. The Credit Facility contains restrictions with respect to investments, mergers and acquisitions, dividends and distributions and redemptions of capital stock, these restrictions become effective only after the Company's debt to EBITDA ratio exceeds 1.0:1.0. At April 30, 2010, the debt to EBITDA ratio was less than 1.0:1.0. As of April 30, 2010, we did not have an outstanding balance under the Credit Facility.

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



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During the nine months ended April 30, 2010, we entered into two contracts to sponsor certain drivers participating in NASCAR (National Association of Stock Car Auto Racing) and NHRA (National Hot Rod Association) events. We also entered into two separate contracts with NHRA to be an official sponsor of NHRA and to participate in race day advertising. The total commitment is approximately \$8.0 million and will be expensed in the period when the sponsored events occur. During the third quarter of fiscal 2010, \$2.2 million was incurred and expensed and the remainder will be incurred and expensed during the fourth quarter of fiscal 2010 and the first and second quarters of fiscal 2011.

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

Our principal exposures to financial market risk are interest rate, foreign currency risk and translation risk.

**Interest Rate Risk**

The primary objective of our investment activities is to preserve principal while secondarily maximizing yields without significantly increasing risk. To achieve this objective in the current uncertain global financial markets, as of April 30, 2010, all of our total cash and cash equivalents were held in bank deposits and money market funds. As the interest rates on a material portion of our cash and cash equivalents are variable, a change in interest rates earned on our investment portfolio would impact interest income along with cash flows, but would not materially impact the fair market value of the related underlying instruments. As of April 30, 2010, we held no direct investments in auction rate securities, collateralized debt obligations, structured investment vehicles or mortgaged-backed securities. Based on the average cash balance held during the nine months ended April 30, 2010, a 10% change in our interest yield would not materially affect our operating results. We do not hedge interest rate fluctuation risks.

**Foreign Currency and Translation Exposure**

Fluctuations in the foreign currencies create volatility in our reported results of operations because we are required to consolidate the results of operations of our foreign currency denominated subsidiaries. International net revenues result from transactions by our Canadian and UK operations and are typically denominated in the local currency of each country. These operations also incur a majority of their expenses in the local currency, the Canadian dollar and the British pound. Our international operations are subject to risks associated with foreign exchange rate volatility. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. A hypothetical uniform 10% strengthening or weakening in the value of the US dollar relative to the Canadian dollar and British pound in which our revenues and profits are denominated would result in a decrease/increase to revenue of approximately \$5.3 million for the three months ended April 30, 2010. There are inherent limitations in the sensitivity analysis presented, due primarily to the assumption that foreign exchange rate movements are linear and instantaneous. As a result, the analysis is unable to reflect the potential effects of more complex market changes that could arise, which may positively or negatively affect income.

Fluctuations in the foreign currencies create volatility in our reported consolidated financial position because we are required to remeasure substantially all assets and liabilities held by our foreign subsidiaries at the current exchange rate at the close of the accounting period. At April 30, 2010, the cumulative effect of foreign exchange rate fluctuations on our consolidated financial position was a net translation loss of approximately \$35.8 million. This loss is recognized as an adjustment to stockholders' equity through accumulated other comprehensive income. A 10% strengthening or weakening in the value of the US dollar relative to the Canadian dollar or the British pound will not have a material affect on our consolidated financial position.

We do not hedge our exposure to translation risks arising from fluctuations in foreign currency exchange rates.

**ITEM 4. CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures

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

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

(b) Changes in Internal Controls

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

**PART II - OTHER INFORMATION**





**ITEM 1. LEGAL PROCEEDINGS**



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The information set forth above under Note 12 Legal Proceedings contained in the Notes to Consolidated Financial Statements is incorporated herein by reference.

### ITEM 1A. RISK FACTORS

Set forth below and elsewhere in this 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, 2009.

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

Historically, a limited number of vehicle sellers have accounted for a substantial portion of our revenues. Seller arrangements are either written or oral agreements typically subject to cancellation by either party upon 30 to 90 days notice. Vehicle sellers have terminated agreements with us in the past in particular markets, which has affected the pricing for sales services in those markets. There can be no assurance that our existing agreements will not be cancelled. Furthermore, there can be no assurance that we will be able to enter into future agreements with vehicle sellers or that we will be able to retain our existing supply of salvage vehicles. A reduction in vehicles from a significant vehicle seller or any material changes in the terms of an arrangement with a substantial vehicle seller could have a material adverse effect on our results of operations and financial condition. In addition, a failure to increase our sources of vehicle supply could adversely affect our earnings and revenue growth rates. During the quarter ended April 30, 2010, no single customer accounted for more than 10% of our revenues.

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

During fiscal 2007, we completed the acquisition of Universal Salvage plc, or Universal, our first acquisition in the UK. In fiscal 2008, we completed the acquisitions of Century Salvage Sales Limited, or Century, Simpson Bros. (York) Holdings, Limited and AG Watson Auto Salvage & Motor Spares (Scotland) Limited, all located within the UK. In fiscal 2010, we completed the acquisition of D Hales Limited which is also located in the UK. We may continue to acquire additional companies or operations in the UK or other countries in Europe or may seek to establish new yards or operations in the UK or Europe now that we have established a presence in these markets. We have limited experience operating our business outside North America, which presents numerous strategic, operational, and financial risks to us.

Our acquisitions in the UK and continued expansion of our operations outside North America pose substantial risks and uncertainties that could have an adverse effect on our future operating results. In particular, we may not be successful in realizing anticipated synergies from these acquisitions, or we may experience unanticipated costs or expenses integrating the acquired operations into our existing business. For example, in the second quarter of fiscal 2008, we experienced losses associated with credit card fraud in the UK. Although historical practice in the UK market has been to accept credit cards, we have not accepted them in North America and may need to further enhance our security systems to reduce the risk of credit card fraud. In addition, our operating expenses were adversely affected in the second quarter of fiscal 2008 by incremental integration expenses. We have and may continue to incur substantial expenses establishing new yards or operations in the UK or Europe. Among other things, we have deployed our VB2 online vehicle auction technologies at all of our operations in the UK and we cannot predict whether this deployment will be



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successful or will result in increases in the revenues or operating efficiencies of any acquired companies relative to their historic operating performance. Integration of our respective operations, including information technology integration and integration of financial and administrative functions, may not proceed as we currently anticipate and could result in presently unanticipated costs or expenses (including unanticipated capital expenditures) that could have an adverse effect on our future operating results. We cannot provide any assurances that we will achieve our business and financial objectives in connection with these acquisitions or our strategic decision to expand our operations internationally.

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

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

- the difficulty of managing and staffing foreign offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- the need to localize our product offerings, particularly with respect to VB2;
- tariffs and trade barriers and other regulatory or contractual limitations on our ability to operate in certain foreign markets; and
- exposure to foreign currency exchange rate risk, which we have not been previously subject to in any material amounts and which had an adverse impact on our revenues and revenue growth rates during the twelve months ended July 31, 2009.

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

Certain acquisitions in the United Kingdom may be reviewed by the Office of Fair Trade (OFT) and/or Competition Commission (UK Regulators). If an inquiry is made by the UK Regulators, we may be required to demonstrate our acquisitions will not result, or be expected to result, in a substantial lessening of competition in a UK market. Although we believe that there will not be a substantial lessening of competition in a UK market, based on our analysis of the relevant UK markets, there can be no assurance that the UK Regulators will agree with us if they decide to make an inquiry. If the UK Regulators determine that by our acquisitions of certain assets, there is or likely will be a substantial lessening of competition in a UK market, we could be required to divest some portion of our UK assets. In the event of a divestiture order by the UK Regulators, 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.

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

- hire, train and manage additional qualified personnel;
- establish new relationships or expand existing relationships with vehicle sellers;
- identify and acquire or lease suitable premises on competitive terms;

- secure adequate capital; and
- maintain the supply of vehicles from vehicle sellers.

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

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

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

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



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- changes in international, state or federal laws or regulations affecting salvage vehicles;
- changes in local laws affecting who may purchase salvage vehicles;
- our ability to integrate and manage our acquisitions successfully;
- the timing and size of our new facility openings;
- the announcement of new vehicle supply agreements by us or our competitors;
- 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;
- the availability of subhaulers at competitive rates;
- acceptance of buyers and sellers of our Internet-based model deploying VB2, a proprietary Internet auction-style sales technology;
- changes in the current levels of out of state and foreign demand for salvage vehicles;

- the introduction of a similar Internet product by a competitor; and
  
- the ability to obtain necessary permits to operate.

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

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

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

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

Litigation based on allegations of infringement or other violations of intellectual property rights are common among companies who rely heavily on intellectual property rights. Our reliance on intellectual property rights has increased significantly in recent years as we have implemented our VB2 auction-style sales technologies across our business and ceased conducting live auctions in our North American operations. As we face increasing competition, the possibility of intellectual property rights claims against us grows. Litigation and any other intellectual property claims, whether with or without merit, can be time-consuming, expensive to litigate and settle, and can divert management resources and attention from our core business. An adverse determination in current or

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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 trucking fleet operations, our business could be harmed.**

We rely solely upon independent subhaulers to pick up and deliver vehicles to and from our North American storage facilities. We also utilize, to a lesser extent, independent subhaulers in the UK. Our failure to pick up and deliver vehicles in a timely and accurate manner could harm our reputation and brand, which could have a material adverse effect on our business. Further, an increase in fuel cost may lead to increased prices charged by our independent subhaulers, 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 UK we utilize a fleet of company trucks to pick up and deliver vehicles from our UK storage facilities. In connection therewith, we are subject to the risks associated with providing trucking services, including inclement weather, disruptions in transportation infrastructure, availability and price of fuel, any of which could result in an increase in our operating expenses and reduction in our net income.

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

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

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

Our executive officers, directors and their affiliates beneficially own, in the aggregate, approximately 16% of our common stock as of April 30, 2010. If they were to act together, these shareholders would have significant influence over most matters requiring approval by shareholders, including the election of directors, any amendments to our articles of incorporation and certain significant corporate transactions, including potential merger or acquisition transactions. In addition, without the consent of these shareholders, we could be delayed or prevented from entering into transactions that could be beneficial to us or our other investors. These shareholders may take these actions even if they are opposed by our other investors.

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

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

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

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

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

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

**The impairment of capitalized development costs could adversely affect our 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 results of operations and financial condition.

**Increased investment in advertising and marketing could adversely impact our operating results.**

In fiscal year 2010 we have increased and in fiscal year 2011 we may increase our investment in advertising and marketing relative to 2009. These amounts may be material to our overall general and administrative expenses and we cannot predict what future benefit, if any, will be derived.

**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 may 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 the year ended July 31, 2006, we recognized substantial additional costs associated with the impact of Hurricanes Katrina and Rita in Gulf Coast states. These additional costs, characterized as abnormal under FASB ASC 330, *Inventory*, were recognized during the year ended July 31, 2006, and included the additional subhauling, payroll, equipment and facilities expenses directly related to the operating conditions created by the hurricanes. In the event that we were to again experience extremely adverse weather or other anomalous conditions that result in an abnormally high number of salvage vehicles in one or more of our markets, those conditions could have an adverse effect on our future operating results.

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

Macroeconomic factors that affect oil prices and the automobile and commodity markets can have adverse effects on our revenues, revenue growth rates (if any), and operating results. Significant increases in the cost of fuel could lead to a reduction in miles driven per car and a reduction in accident rates. A material reduction in accident rates could have a material impact on revenue growth. In addition, under our percentage incentive program contracts, or PIP, the cost of towing the vehicle to one of our facilities is included in the PIP fee. We may incur increased fees, which we may not be able to pass on to our vehicle sellers. A material increase in tow rates could have a material impact on our operating results. Recently, the markets in which we operate have been particularly

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affected by changes in fuel prices, commodity prices, and decreases in the prices of used cars. In particular, declines in scrap metal and used car prices had an adverse impact on our revenue growth rates during the twelve months ended July 31, 2009. Continued volatility in fuel, commodity, and used car prices could have a material adverse effect on our revenues and revenue growth rates in future periods.

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

We face significant competition for the supply of salvage vehicles and for the buyers of those vehicles. We believe our principal competitors include other 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 UK, the absence of long-term contractual commitments between us and our sellers and the increasingly competitive market environment, there can be no assurance that our competitors will not gain market share at our expense.

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

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

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

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

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

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

Our operations are subject to federal, state, national, provincial and local laws and regulations regarding the protection of the environment in the countries which we have storage facilities. In the salvage vehicle remarketing industry, large numbers of wrecked vehicles are stored at storage facilities and, during that time, spills of fuel, motor oil and other fluids may occur, resulting in soil,

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surface water or groundwater contamination. In addition, certain of our facilities generate and/or store petroleum products and other hazardous materials, including waste solvents and used oil. In the UK, we provide vehicle de-pollution and crushing services for End-of-Life program vehicles. We could incur substantial expenditures for preventative, investigative or remedial action and could be exposed to liability arising from our operations, contamination by previous users of certain of our acquired facilities, or the disposal of our waste at off-site locations. Environmental laws and regulations could become more stringent over time and there can be no assurance that we or our operations will not be subject to significant costs in the future. Although we have obtained indemnification for pre-existing environmental liabilities from many of the persons and entities from whom we have acquired facilities, there can be no assurance that such indemnifications will be adequate. Any such expenditures or liabilities could have a material adverse effect on our results of operations and financial condition.

**The recent financial crisis and economic downturn may negatively affect our business, operating results, or financial condition.**

The capital and credit markets have been experiencing extreme volatility and disruption for over a year, which has led to an economic downturn in the US and abroad. As a result of the ongoing financial crisis and economic downturn, the number of miles driven may continue to decrease, which may lead to fewer accident claims, a reduction of vehicle repairs, and fewer salvage vehicles. Adverse credit conditions may also affect the ability of buyers to secure financing to purchase salvaged vehicles which may adversely affect demand. In addition if the banking system or the financial markets deteriorate or remain volatile our banking institution may reduce our line of credit.

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

Goodwill represents the excess of cost over the fair market value of assets acquired in business combinations. In recent periods, the amount of goodwill on our balance sheet has increased substantially, principally as a result of a series of acquisitions we have made in the UK since 2007. As of April 30, 2010, the amount of goodwill on our balance sheet subject to future impairment testing was approximately \$173.8 million.

Pursuant to FASB ASC 350, *Intangibles - Goodwill and Other*, we are required to annually test goodwill and intangible assets with indefinite lives to determine if impairment has occurred. 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 or other intangible assets and the implied fair value of the goodwill or other intangible assets in the period the determination is made. The testing of goodwill and other intangible assets for impairment requires us to make significant estimates about our future performance and cash flows, as well as other assumptions. These estimates can be affected by numerous factors, including changes in the definition of a business segment in which we operate, changes in economic, industry or market conditions, changes in business operations, changes in competition or potential changes in the share price of our common stock and market capitalization. Changes in these factors, or changes in actual performance compared with estimates of our future performance, could affect the fair value of goodwill or other intangible assets, which may result in an impairment charge. For example, continued deterioration in worldwide economic conditions could affect these assumptions and lead us to determine that a goodwill impairment is required with respect to our acquisitions in the UK. We cannot accurately predict the amount or timing of any impairment of assets. Should the value of our goodwill or other intangible assets become impaired, it could have a material adverse effect on our operating results and could result in our incurring net losses in future periods.

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

The Financial Accounting Standards Board, or the FASB, 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 financial condition or results of operations, 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 and, 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 not exceed their benefits. Fluctuations in the rate of exchange between the US dollar and foreign currencies, primarily the British Pound and Canadian Dollar, could adversely affect our financial results.

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**Fluctuations in the US unemployment rates could result in declines in revenue from processing insurance cars.**

Increases in unemployment 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.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. REMOVED AND RESERVED**

**ITEM 5 OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

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(a) Exhibits

- 31.1 Certification of A. Jayson Adair, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of William E. Franklin, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of A. Jayson Adair, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of William E. Franklin, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURES**

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

COPART, INC.

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

Date: June 9, 2010