

COPART INC  
Form 10-Q  
June 09, 2006

**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, 2006**

**OR**

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

Commission file number: 0-23255

**COPART, INC.**

(Exact name of registrant as specified in its charter)

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

**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.

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YES  NO

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

Large Accelerated Filer  Accelerated Filer  Non - Accelerated Filer

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

YES  NO

Number of shares of Common Stock outstanding as of June 8, 2006: 90,378,563

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April 30, 2006**

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**PART 1 - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

**Copart, Inc. and Subsidiaries**  
**Consolidated Balance Sheets**  
(in thousands)  
(Unaudited)

	April 30, 2006	July 31, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 124,012	\$ 252,548
Short-term investments	127,900	
Accounts receivable, net	112,845	89,002
Vehicle pooling costs	32,692	25,983
Prepaid expenses and other assets	6,550	8,595
Assets held for sale	3,696	32,434
Total current assets	407,695	408,562
Property and equipment, net	320,886	284,245
Intangibles, net	2,063	1,308
Goodwill	112,230	93,276
Deferred income taxes	5,929	
Land purchase options and other assets	21,060	6,138
Total assets	\$ 869,863	\$ 793,529
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 62,687	\$ 56,964
Deferred revenue	20,729	12,478
Income taxes payable	1,292	7,248
Deferred income taxes	8,849	3,296
Other current liabilities	126	126
Total current liabilities	93,683	80,112
Deferred income taxes		2,878
Other liabilities	1,174	1,160
Total liabilities	94,857	84,150
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value - 180,000 shares authorized; 90,350 and 90,338 shares issued and outstanding at April 30, 2006 and July 31, 2005, respectively	272,344	272,017
Accumulated other comprehensive income	280	354
Retained earnings	502,382	437,008
Total shareholders' equity	775,006	709,379
Total liabilities and shareholders' equity	\$ 869,863	\$ 793,529

See accompanying notes to consolidated financial statements.

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

	Three months ended April 30,		Nine months ended April 30,	
	2006	2005	2006	2005
Revenues	\$ 149,512	\$ 127,772	\$ 391,351	\$ 337,156
Operating costs and expenses:				
Yard operations	80,048	68,833	223,779	186,366
General and administrative	16,113	11,483	43,207	31,955
Total operating expenses	96,161	80,316	266,986	218,321
Operating income	53,351	47,456	124,365	118,835
Other income (expense):				
Interest income, net	1,805	1,214	5,385	3,030
Other income, net	111	701	1,499	2,690
Equity in losses of unconsolidated investment	(1,578 )		(2,428 )	
Total other income	338	1,915	4,456	5,720
Income from continuing operations before income taxes	53,689	49,371	128,821	124,555
Income taxes	20,509	18,658	46,950	47,829
Income from continuing operations	33,180	30,713	81,871	76,726
Discontinued operations:				
Income (loss) from discontinued operations, net of income tax effects	1,530	192	(16,497 )	401
Net income	\$ 34,710	\$ 30,905	\$ 65,374	\$ 77,127
Earnings per share-basic				
Income from continuing operations	\$ 0.37	\$ 0.34	\$ 0.91	\$ 0.86
Income (loss) from discontinued operations	0.01	0.00	(0.19 )	0.00
Basic net income per share	\$ 0.38	\$ 0.34	\$ 0.72	\$ 0.86
Weighted average shares outstanding	90,293	90,179	90,360	90,127
Earnings per share-diluted				
Income from continuing operations	\$ 0.36	\$ 0.33	\$ 0.88	\$ 0.83
Income (loss) from discontinued operations	0.01	0.00	(0.18 )	0.00
Diluted net income per share	\$ 0.37	\$ 0.33	\$ 0.70	\$ 0.83
Weighted average shares and dilutive potential common shares outstanding	92,884	93,100	92,883	92,931

See accompanying notes to consolidated financial statements.

**Copart, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(in thousands)  
(Unaudited)

	<b>Nine Months Ended April 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 65,374	\$ 77,127
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss (gain) on discontinued operations	19,342	(401 )
Depreciation and amortization	22,920	23,626
Deferred rent	14	87
Share-based compensation	2,482	
Loss (gain) on sale of property and equipment	355	(697 )
Deferred income taxes	(3,254 )	1,731
Equity in loss of unconsolidated entity	2,428	
Changes in operating assets and liabilities:		
Accounts receivable	(22,652 )	(11,860 )
Vehicle pooling costs	(5,782 )	(1,021 )
Prepaid expenses and other assets	2,073	(2,181 )
Land purchase options and other assets	605	(29 )
Accounts payable and accrued liabilities	5,921	6,459
Deferred revenue	8,265	3,038
Income taxes payable	(5,956 )	6,297
Net cash provided by operating activities from continuing operations	92,135	102,176
Net cash provided by operating activities from discontinued operations	279	910
Net cash provided by operating activities	92,414	103,086
<b>Cash flows from investing activities:</b>		
Purchases of short-term investments	(510,970 )	(341,020 )
Sales of short-term investments	383,070	513,620
Purchase of property and equipment	(59,522 )	(42,122 )
Proceeds from sales of property and equipment	599	5,520
Purchases of goodwill, intangibles, property and equipment and net current assets in connection with acquisitions	(22,859 )	(3,393 )
Investment in unconsolidated entity	(8,934 )	
Net cash (used in) provided by investing activities from continuing operations	(218,616 )	132,605
Net cash provided by (used in) investing activities from discontinued operations	8	(48 )
Net cash (used in) provided by investing activities	(218,608 )	132,557
<b>Cash flows from financing activities:</b>		
Proceeds from the exercise of stock options	4,680	1,082
Proceeds from the issuance of Employee Stock Purchase Plan shares	817	662
Repurchases of common stock	(8,873 )	
Excess tax benefit from share-based payment arrangements	1,222	660
Principal payments on notes payable		(5 )
Net cash (used in) provided by financing activities from continuing operations	(2,154 )	2,399
Net cash provided by financing activities from discontinued operations		
Net cash (used in) provided by financing activities	(2,154 )	2,399
Effect of foreign currency changes on cash and cash equivalents	(188 )	141
Net (decrease) increase in cash and cash equivalents	(128,536 )	238,183
Cash and cash equivalents at beginning of period	252,548	5,720
Cash and cash equivalents at end of period	\$ 124,012	\$ 243,903
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for income taxes	\$ 52,947	\$ 39,390
Non-cash note receivable from sale of discontinued operations	\$ 8,889	\$

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See accompanying notes to consolidated financial statements.

**Copart, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**April 30, 2006**  
**(Unaudited)**

NOTE 1 General:

*Description of Business*

Copart, Inc. and its subsidiaries ( the Company ) provide vehicle suppliers, primarily insurance companies, with a full range of services to process and sell salvage vehicles over the Internet through its Virtual Bidding Second Generation ( VB2 ) Internet auction-style sales technology. The Company sells principally to licensed vehicle dismantlers, rebuilders, repair licensees, used vehicle dealers and exporters. Salvage vehicles are either damaged vehicles deemed a total loss for insurance or business purposes or are recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. The Company offers vehicle suppliers a full range of services that expedite each stage of the salvage vehicle sales process and minimize administrative and processing costs.

*Principles of Consolidation*

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, 2006 and July 31, 2005, and its consolidated statements of income and cash flows for the three months and nine months ended April 30, 2006 and April 30, 2005. Interim results for the nine months ended April 30, 2006, are not necessarily indicative of the results that may be expected for the year ending July 31, 2006. 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, 2005. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. The Company reclassified \$32.4 million to assets held for sale from property and equipment, goodwill and intangibles as of July 31, 2005. These reclassifications had no impact on the Company s results of operations or cash flows.

*Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 consolidated financial statements and reported consolidated results of operations during the reporting period. Estimates are used for, but not limited to, vehicle pooling costs, allowance for doubtful accounts, goodwill, income taxes, share-based compensation and long-lived assets. Actual results could differ from those estimates.

*Income Taxes*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. 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.

During the second quarter of fiscal 2006, the Company identified an error in the way it calculated certain deferred tax liabilities in 2001 and prior years. As a result of this discovery, the Company recorded an out-of-period reduction to deferred tax liabilities and income tax expense in the amount of \$1.8 million. Without this tax benefit, income from continuing operations for the nine months ended April 30, 2006 would have been \$80.1 million. Basic income per share from continuing operations for the nine months ended April 30, 2006 would have been \$0.89. Diluted income per share from continuing operations would have been \$0.86 for the nine months ended April 30, 2006. Basic net income per share for the nine months ended April 30, 2006 would have been \$0.72. Diluted net income per share would have been \$0.70 for the nine months ended April 30, 2006.





**NOTE 2 Vehicle Pooling Costs:**

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

The operating results for the first, second and third quarters of 2006 were adversely affected by incremental costs, characterized as abnormal in Financial Accounting Standards ( FAS ) 151: Inventory Costs, incurred as a result of Hurricanes Katrina and Rita. These additional inventory-type costs, characterized as abnormal and charged to yard operations costs, are approximately \$2.6 million and \$12.0 million for the three and nine month periods ended April 30, 2006, respectively. These costs include the additional subhauling, payroll, equipment and facilities expenses directly related to the operating conditions created by the hurricanes and will continue. These costs do not include normal expenses associated with the increased unit volume created by the hurricanes, which are deferred until the sale of the units and are recognized as vehicle pooling costs on the balance sheet. At the end of the quarter, approximately 64% of the incremental salvage vehicles received as a result of the hurricanes remained unsold and in inventory. The Company expects the majority of these vehicles to be sold primarily in the next two quarters, provided that the Gulf Coast region does not experience additional hurricanes or severe weather. The processing of the hurricane vehicles has had and may continue to have a negative impact on gross and operating margin percentages.

**NOTE 3 Net Income Per Share:**

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

	Three months ended April 30,		Nine months ended April 30,	
	2006	2005	2006	2005
Basic weighted average shares outstanding	90,293	90,179	90,360	90,127
Effect of dilutive securities - stock options	2,591	2,921	2,523	2,804
Diluted weighted average shares outstanding	92,884	93,100	92,883	92,931

Options to purchase 48,000 and 43,500 shares of common stock at a weighted average price of \$27.21 and \$23.77 per share were outstanding during the three months ended April 30, 2006 and 2005, respectively, and 53,000 and 63,000 shares of common stock at a weighted average price of \$25.89 and \$23.48 were outstanding during the nine months ended April 30, 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares.

**NOTE 4 Short-term Investments:**

Short-term investments consist primarily of AAA rated auction rate securities with readily determinable fair market values and with original maturities in excess of three months. Auction rate securities are principally variable rate securities tied to short-term interest rates. Auction rate securities have interest rate resets through a modified Dutch auction, at predetermined short-term intervals, usually every 7, 28 or 35 days. They trade at par and are callable at par on any interest payment date at the option of the issuer. Interest paid during a given period is based upon the interest rate determined during the prior auction. Although these instruments are issued and rated as long-term securities, they are priced and traded as short-term securities because of the liquidity provided through the interest rate reset.

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



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

	April 30, 2006	July 31, 2005
Available-for-sale securities:		
Auction rate securities	\$ 127,900	\$
Total short-term investments	\$ 127,900	\$

#### NOTE 5 Discontinued Operations and Goodwill Impairment

During the prior quarter the Company adopted a formal plan to discontinue the operations of its public auction business Motors Auction Group (MAG) and dispose of or convert the related assets. The MAG yards to be converted into salvage facilities will continue to be included in the results of continuing operations on the income statements. The assets of the MAG locations to be disposed of have been classified as assets held for sale in the balance sheets pursuant to Statement of Financial Accounting Standards (SFAS) No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets.

Under SFAS No 142, Goodwill and Other Intangible Assets, goodwill is subject to at least an annual assessment for impairment by applying a fair value-based test or on an interim basis if certain indicators are present. The discontinuation of an operating segment is one of those indicators. Accordingly, goodwill was tested for impairment in accordance with the provisions of SFAS No. 142 as of the second quarter of 2006. The Company used a combination of valuation techniques, which included consideration of market-based approaches and an income approach, in determining the fair value of the Company's applicable reporting unit in the interim impairment test of goodwill.

The impairment test indicated that the carrying value of the MAG assets exceeded their implied fair values. The corresponding write-down of goodwill of \$21.8 million to its fair value was reported as a component of discontinued operations in the accompanying consolidated statements of income. The Company also determined that the value of the remaining MAG covenants not to compete were impaired and recorded an impairment expense in the amount of \$0.5 million. This write-down of covenants not to compete is also reported as a component of discontinued operations in the accompanying consolidated statements of income.

During the current quarter, the Company sold the business and related assets including the real estate of one of the MAG locations. The Company received a \$12 million promissory note from the buyer as purchase consideration. The promissory note bears interest at 7% per annum. Interest only payments on the note are due monthly until maturity on May 28, 2011. At maturity the balance of the note is due in full. The note receivable is collateralized by the real estate and is personally guaranteed by the buyer. The consideration was allocated to the real estate, based on an appraisal, and to the business in proportion to their estimated fair values. The portion of the consideration allocated to the real estate sale totaled \$7.1 million. The Company deferred a gain on the sale of the real estate of approximately \$2.5 million that will be recognized as the Company receives payments of principal on the \$7.1 million portion of the amount allocated to the real estate. The remaining consideration of \$4.9 million is allocated to the sale of the business. The Company recognized a gain on the sale of the business of approximately \$3.0 million, which is included in the results of the discontinued operations. As of April 30, 2006 two MAG locations remain, as two of the original six MAG locations were sold and two are being converted into salvage facilities.

Summarized results of operations for MAG is set forth below (in thousands):

	Three months ended April 30,		Nine months ended April 30,	
	2006	2005	2006	2005
Net revenue	\$ 2,000	\$ 2,700	\$ 6,200	\$ 7,400
Income (loss) before income taxes	3,501	192	(18,826)	401
Income tax (expense) benefit	(1,971)	)	2,329	
Net income (loss) from discontinued operations	\$ 1,530	\$ 192	\$ (16,497)	\$ 401



NOTE 6 Acquisitions

During the nine months ended April 30, 2006 the Company acquired the assets of three vehicle salvage disposal companies. These three companies consisted of seven separate facilities. Aggregate consideration for the acquisitions consisted of \$22.9 million in cash. During the nine months ended April 30, 2005 the Company acquired the assets of one vehicle salvage disposal company.

The results of operations of the acquired facilities have been included in the Company's consolidated financial statements from their respective acquisition dates.

The acquired net assets consisted of accounts and advance receivables, vehicle costs, goodwill and covenants not to compete. The acquisitions were accounted for using the purchase method of accounting. The excess of the purchase price over the estimated fair value of the net identifiable assets acquired of \$19.0 million has been recorded as goodwill. The Company estimates that the entire goodwill balance relating to these acquisitions will be deductible for tax purposes. In addition the Company paid \$1.3 million for covenants not to compete relating to these acquisitions, which are being amortized over five years.

Pro forma financial information for these acquisitions did not result in a significant change from actual results for the quarter or nine months ended April 30, 2006.

NOTE 7 Goodwill and Intangible Assets

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



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Balance as of August 1, 2004	\$ 89,592
Goodwill acquired during the period	3,684
Balance as of August 1, 2005	\$ 93,276
Goodwill acquired during the period	18,954
Balance as of April 30, 2006	\$ 112,230



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The goodwill balances above exclude the reclassification of goodwill related to the discontinued operations as discussed in Note 5 above.

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

	April 30, 2006	July 31, 2005
Amortized intangibles:		
Covenants not to compete	\$ 9,900	\$ 8,650
Accumulated amortization	(7,837)	(7,342)
Net intangibles	\$ 2,063	\$ 1,308

Aggregate amortization expense on intangible assets was \$0.2 million and \$0.2 million for the three months and \$0.5 million and \$0.8 million for the nine months ended April 30, 2006 and 2005, respectively. The average life of the covenants not to compete is approximately five years. Estimated amortization expense for each of the five succeeding fiscal years is as follows (in thousands):

2006 (three months remaining)	\$ 189
2007	689
2008	418
2009	336
2010	300
Thereafter	131
Total	\$ 2,063

## NOTE 8 Stock-Based Compensation:

In December 2001, the Company adopted the Copart, Inc. 2001 Stock Option Plan ( Plan ), presently covering an aggregate of 4.5 million shares of the Company's Common Stock. The Plan provides for the grant of incentive stock options to employees and non-qualified stock options to employees, officers, directors and consultants at prices not less than 100% and 85% of the fair market value for incentive and non-qualified stock options, respectively, as determined by the Board of Directors at the grant date. Incentive and non-qualified stock options may have terms of up to ten years and vest over periods determined by the Board of Directors. Options generally vest ratably over a five-year period. The Plan replaced the Company's 1992 Stock Option Plan ( 1992 Plan ), which expired in August 2002. The 1992 Plan had the same terms as the Plan.

The Copart, Inc. Employee Stock Purchase Plan ( ESPP ) provides for the purchase of up to an aggregate of 1.5 million shares of Common Stock of the Company by employees pursuant to the terms of the ESPP. The Company's ESPP was adopted by the Board of Directors and approved by the shareholders in 1994. The ESPP was amended and restated in 2003 and again approved by the shareholders. Under the ESPP, employees of the Company who elect to participate have the right to purchase common stock at a 15 percent discount from the lower of the market value of the common stock at the beginning or the end of each six month offering period. The ESPP permits an enrolled employee to make contributions to purchase shares of common stock by having withheld from their salary an amount up to 10 percent of their compensation (which amount may be increased from time to time by the Company but may not exceed 15% of compensation). No employee may purchase more than \$25,000 worth of common stock (calculated at the time the purchase right is granted) in any calendar year. The Compensation Committee of the Board of Directors administers the ESPP.

On August 1, 2005, the Company adopted the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123(R) (revised 2004), Share-Based Payments , or SFAS 123(R), requiring it to recognize expense related to the fair value of its share-based compensation awards. The Company elected to use the modified prospective transition method as permitted by SFAS 123(R) and therefore has not restated its financial results for prior periods. Under this transition method, share-based compensation expense for the three and nine months ended April 30, 2006 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 SFAS 123 Accounting for Stock-Based Compensation , net of estimated forfeitures. Share-based compensation expense for all share-based compensation awards granted subsequent to August 1, 2005 was based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). For options issued subsequent to August 1, 2005 the Company recognizes compensation expense for stock option awards on a straight-line basis over the requisite service period of the award. For options issued prior to August 1, 2005 the Company recognizes compensation expense for stock option awards on a graded vesting basis over the requisite service period of the award.

The following table sets forth the total share-based compensation expense resulting from stock options and non-vested stock awards, included in the Company's Consolidated Statements of Income (in thousands):

	Three months ended April 30, 2006	Nine months ended April 30, 2006
Yard operations	\$ 175	\$ 642
General and administration	686	1,840
Total share-based compensation expense	\$ 861	\$ 2,482

As a result of adopting SFAS 123(R) on August 1, 2005, the Company's net income for the three and nine months ended April 30, 2006, was \$0.5 million and \$1.6 million, respectively, lower than if it had continued to account for share-based compensation under Opinion 25. If the Company had not adopted SFAS 123(R), basic earnings per share for the three and nine months ended April 30, 2006 would have been \$0.39 and \$0.74 as compared to \$0.38 and \$0.72. If the Company had not adopted SFAS 123(R), diluted earnings per share for the three and nine months ended April 30, 2006 would have been \$0.38 and \$0.72 as compared to \$0.37 and \$0.70.

Net cash proceeds from the exercise of stock options were \$1.6 million and \$0.5 million for the three months ended April 30, 2006 and 2005, respectively and \$4.7 million and \$1.1 million for the nine months ended April 30, 2006, and 2005, respectively. We realized an income tax benefit of \$0.4 million from stock option exercises during the three months ended April 30, 2006 and 2005 and \$1.2 million and \$0.7 million for the nine months ended April 30, 2006, and April 30, 2005, respectively. In accordance with SFAS 123(R), we present excess tax benefits from disqualifying dispositions of the exercise of incentive stock options, vested prior to August 1, 2005, if any, as financing cash flows rather than operating cash flows.



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Prior to the adoption of SFAS 123(R), we applied SFAS 123, amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure (SFAS 148), which allowed companies to apply the existing accounting rules under APB 25 and related interpretations. In general, as the exercise price of options granted under these plans was equal to the market price of the underlying common stock on the grant date, no share-based employee compensation cost was recognized in our net income. As required by SFAS 148 prior to the adoption of SFAS 123(R), we provided pro forma net income and pro forma net income per common share disclosures for share-based awards, as if the fair-value-based method defined in SFAS 123 had been applied.

The following table illustrates the effect on net income after tax and net income per common share as if we had applied the fair value recognition provisions of SFAS 123 to share-based compensation during the three and nine month periods ended April 30, 2005 (in thousands, except per share amounts):

	Three months ended April 30, 2005	Nine months ended April 30, 2005
Net income as reported	\$ 30,905	\$ 77,127
Add: total employee share-based compensation expense included in net income as reported, net of related tax effects		
Deduct: Total employee share-based compensation expense determined under fair value method for all awards, net of related tax effects	(462	) (1,608
Pro forma net income	\$ 30,443	\$ 75,519
Pro forma net income per share:		
Basic as reported	\$ 0.34	\$ 0.86
Basic pro forma	\$ 0.34	\$ 0.84
Diluted as reported	\$ 0.33	\$ 0.83
Diluted pro forma	\$ 0.33	\$ 0.81

The fair value of stock-based awards was estimated using the Black-Scholes model with the following assumptions for the nine months ended April 30, 2006 and 2005, respectively:

	Nine months ended April 30, 2006		Nine months ended April 30, 2005	
Expected life (in years)	3.2	5.9	5.0	
Interest rate	3.2	4.85	%	3.7
Volatility	34%	46	%	40
Dividend yield	0		%	0
Weighted-average fair value at grant date	\$	10.07	\$	4.82

**Expected Term** The Company's expected term represents the period that the Company's stock-based awards are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the share-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its share-based awards.

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**Expected Volatility** The Company uses the trading history and implied volatility of its common stock in determining an estimated volatility factor when using the Black-Scholes option-pricing formula to determine the fair value of options granted.

**Expected Dividend** The Company has not declared dividends. Therefore, the Company uses a zero value for the expected dividend value factor when using the Black-Scholes option-pricing formula to determine the fair value of options granted.

**Risk-Free Interest Rate** The Company bases the risk-free interest rate used in the Black-Scholes valuation method on the implied yield currently available on U.S. Treasury zero-coupon issues with the same or substantially equivalent remaining term.

**Estimated Forfeitures** When estimating forfeitures, the Company considers voluntary and involuntary termination behavior as well as analysis of actual option forfeitures.

Stock option activity for the nine months ended April 30, 2006, is as follows:

	Shares (in 000 s)	Weighted-average exercise price	Weighted-average remaining contractual term	Aggregate intrinsic value (in 000 s)
Outstanding at July 31, 2005	5,463	\$ 11.09		
Grants of options	902	\$ 24.15		
Exercises	(340 )	\$ 14.22		
Forfeitures or expirations	(89 )	\$ 17.78		
Outstanding at April 30, 2006	5,936	\$ 12.80	5.60	\$ 83,424
Exercisable at April 30, 2006	4,176	\$ 10.05	4.41	\$ 70,167

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between the Company's closing stock price on the last trading day of the third quarter of fiscal 2006 and the exercise price, times the number of shares) that would have been received by the option holders had all option holders exercised their options on April 30, 2006. This amount changes based on the fair market value of our stock. Total intrinsic value of options exercised was \$4.3 million and \$1.4 million for the nine months ended April 30, 2006 and 2005, respectively.

As required by SFAS 123(R), the Company made an estimate of expected forfeitures and is recognizing compensation cost only for those equity awards expected to vest.

As of April 30, 2006, \$9.5 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted average term of 3.2 years.

As of April 30, 2006, the amount of shares under the various plans is sufficient to cover future stock option exercises. The Company will issue new shares of common stock to satisfy such future exercises.

### NOTE 9 Common Stock Repurchases:

In February 2003, the Company's Board of Directors authorized the Company to repurchase up to nine million shares of its Common Stock. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. The repurchases will be made at such times and in such amounts, as the Company deems appropriate and may be discontinued at any time. The Company repurchased 366,000 shares during the nine months ended April 30, 2006 at a weighted average price of \$24.24. As of April 30, 2006, the Company had repurchased a total of 4.0 million shares at a weighted average price of \$9.92. Five million shares remain authorized for repurchase.



## 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,	
	2006	2005	2006	2005
Net income, as reported	\$ 34,710	\$ 30,905	\$ 65,374	\$ 77,128
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax	(102 )	55	(74 )	213
Total other comprehensive income	\$ 34,608	\$ 30,960	\$ 65,300	\$ 77,341

## NOTE 11 Recent Accounting Pronouncements:

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections ( SFAS No. 154 ), which replaces Accounting Principles Board ( APB ) Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effect or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

## NOTE 12 Investment in Unconsolidated Entity:

During the three months ended October 31, 2005 the Company committed to invest \$9.0 million for a 50% equity interest in a limited liability corporation (the LLC ) of which \$3.0 million was contributed during the three months ended October 31, 2005 and \$6.0 million was contributed during the three months ended January 31, 2006. The Company has no further contractual funding commitment. Based on the Company s evaluation of the LLC and related agreements, management believes the LLC does not constitute a Variable Interest Entity as defined in FASB Interpretation No.46, Consolidation of Variable Interest Entities . As a result, the Company s investment has been accounted for under the equity method prescribed by Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock .

## NOTE 13 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, handling or disposal of vehicles and patent infringement. The Company is also involved in various governmental and administrative proceedings primarily relating to licensing and operation of our business. Among this litigation is a lawsuit filed by Ciano Dessources on May 21, 2003 in the Commonwealth of Massachusetts, Superior Court Department against Copart of Connecticut, Inc. and Copart, Inc., which purports to be a class action on behalf of persons whose vehicles were disposed of by the Company as abandoned vehicles, and which the named plaintiff contends were disposed of without complying with state laws. Relief sought included class certification, declaratory, remedial and/or injunctive relief, including the ordering of a compliance program that will essentially protect consumers, as well as damages, fees, and costs. Copart s Motion for Summary Judgment was granted on December 8, 2004, dismissing the class claim element of the lawsuit. However this dismissal may be reconsidered, and may also be appealed once the remaining individual claims of the named plaintiff are adjudicated.

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

On September 16, 2005, Richard M. Gray filed suit against Copart and A. Safrin, in the State Court for the County of Chatham, State of Georgia, alleging a class action for unreasonable amounts claimed for storage liens by the Company, and related claims. Relief sought included class certification, damages, fees, costs and expenses. On October 20, 2005, the Company denied the claims and on May 12, 2006 the Company filed a motion for summary judgment. No trial date has been set.

The Company provides for costs relating to these matters when a loss is probable and the amount can be reasonably estimated. The effect of the outcome of these matters on the Company's future results of operations cannot be predicted because any such effect depends on future results of operations, and the amount and timing of the resolution of such matters. The Company believes that any ultimate liability will not have a material effect on its financial position, results of operations or cash flows. However, the amount of the liabilities associated with these claims cannot be determined with certainty, if any.



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

*This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In some cases, you can identify forward-looking statements by terms such as may, will, should, expect, plan, intend, forecast, anticipate, believe, estimate, predict, potential, continue or the negative of these terms or other comparable terminology. The forward-looking statements contained in this report involve known and unknown risks, uncertainties and situations that may cause our or our industry's actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. These factors include those listed under the caption Risk Factors beginning on page 24 of this report and those discussed elsewhere in this report. We encourage investors to review these factors carefully.*

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

### Overview

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

At the election of the vehicle supplier, we sell vehicles pursuant to our Percentage Incentive Program ( PIP ) consignment basis or on a fixed fee consignment basis. Under the PIP program, we agree to sell all of the salvage vehicles of a vehicle supplier in a specified market usually for a predetermined percentage of the vehicle sales price. Under our fixed fee consignment program, we sell vehicles for a fixed consignment fee. 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.

Our revenues consist of salvage fees charged to vehicle suppliers and vehicle buyers, transportation revenue and purchased vehicle revenues. Salvage fees from vehicle suppliers include sales fees under PIP agreements and fixed fee programs where we charge for title processing, special preparation, storage and selling. Salvage fees also include fees charged to vehicle buyers for purchasing vehicles, storage and annual registration. Transportation revenue includes charges to suppliers for towing vehicles under certain contracts. Transportation revenue also includes towing charges assessed to buyers for delivering vehicles. Purchased vehicle revenues are comprised of the price that buyers paid at our sales for vehicles processed that we own.

Costs attributable to yard and fleet expenses consist primarily of operating personnel (which includes yard management, clerical and yard employees), rent, contract vehicle towing, insurance, fuel, equipment maintenance and repair, and costs of vehicles we sold under purchase contracts. 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, we converted all of our salvage vehicle auction facilities to an Internet based auction-style model using our VB2 Internet sales technology. This process employs a two-step bidding process. The first step, called the preliminary bid, allows buyers to submit bids up to one hour before a real time virtual action 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.

During the three months ended January 31, 2006 we adopted a formal plan to discontinue the operations of our public auction business Motors Auction Group ( MAG ) and dispose of or convert the related assets. The MAG yards to be converted into salvage facilities will continue to be included in the results of continuing operations on the income statements. The assets of the MAG locations to be disposed of have been classified as assets held for sale in the balance sheets pursuant to Statement of Financial Accounting Standards (SFAS) No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets .



The period-to-period comparability of our operating results and financial condition is substantially affected by business acquisitions and new openings made by us during such periods.

### **Acquisitions and New Operations**

We have experienced significant growth as we have acquired or opened 23 facilities since the beginning of fiscal 2004. All of the acquisitions have been accounted for using the purchase method of accounting.

As part of our overall expansion strategy of offering integrated service to vehicle suppliers, we anticipate acquiring and developing facilities in new regions, as well as the regions currently served by our facilities. As part of this strategy, in fiscal 2006, we acquired facilities in or near Billings, Montana; Fruitland, Maryland; Altoona, Pennsylvania; Chambersburg, Pennsylvania; York Haven, Pennsylvania; Greenwood, Nebraska and Grand Island, Nebraska and opened new facilities in Lansing, Michigan and Honolulu, Hawaii. In fiscal 2005 we acquired new facilities in or near Lexington, Kentucky and Columbia, Missouri and opened new facilities in Strongsville, Ohio; Ocala, Florida; Knoxville, Tennessee; Loganville, Georgia; Spokane, Washington; Tallahassee, Florida; and Hialeah, Florida. In fiscal 2004 we acquired new facilities in or near Eugene, Oregon; Cleveland, Ohio; and Anchorage, Alaska and opened new facilities in or near Toronto, Canada and Helena, Montana. We believe that these acquisitions and openings strengthen our coverage as we have 120 facilities located in North America and are able to provide national coverage for our suppliers.

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

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

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to vehicle pooling costs, allowance for doubtful accounts, goodwill, income taxes, long-lived assets and self insured liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

#### ***Revenue Recognition***

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

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

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



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

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

#### ***Vehicle Pooling Costs***

We defer, in vehicle pooling costs, certain yard and fleet expenses associated with vehicles consigned to and received by us but not sold as of the balance sheet date. 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 and fleet 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 and fleet expenses could increase or decrease correspondingly in the future. These costs are expensed as vehicles are sold in the subsequent periods on an average cost basis.

We apply the provisions of Financial Accounting Standards Board ( FASB ), SFAS No. 151, Inventory Costs ( SFAS 151 ) to our vehicle pooling costs. SFAS 151 requires that items such as idle facility expense, excessive spoilage, double freight and rehandling costs be recognized as current-period charges regardless of whether they meet the criteria of so abnormal as provided in Accounting Research Bulletin No. 43, Chapter 4, Inventory Pricing. In addition, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of production facilities. The adoption of SFAS 151 increased yard expenses in the three- and nine-month periods ended April 30, 2006 as the Company incurred additional subhauling, payroll, equipment, and facilities costs associated with hurricanes Katrina and Rita.

#### ***Allowance for Doubtful Accounts***

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

#### ***Valuation of Goodwill and Intangibles***

We evaluate separately the impairment of goodwill of our salvage and our public sales 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 an operating segment could result in an inability to recover the carrying value of the investment, thereby requiring impairment charges in the future.

#### ***Deferred Tax Assets***

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

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

#### ***Long-lived Asset Valuation***

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We evaluate long-lived assets 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 a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by 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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### ***Share-Based Compensation***

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

### ***Retained Insurance Liabilities***

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

### **Results of Operations**

#### ***Three Months Ended April 30, 2006 Compared to Three Months Ended April 30, 2005***

Revenues were approximately \$149.5 million during the three months ended April 30, 2006, an increase of approximately \$21.7 million, or 17.0%, over the three months ended April 30, 2005. The increase was due to increased vehicle sales volume and increased revenue per transaction driven by increased auction proceeds per vehicle. The increase in gross proceeds per vehicle (the gross sales price of the vehicle at auction) yields higher revenue per car as buyer fees and certain seller fees, including those sold under the PIP program are based on the gross proceeds per vehicle and generally increase as gross proceeds per vehicle grow. We believe the increase in recent periods in proceeds per vehicle has been largely attributable to VB2, which allows more buyers to participate in the auctions. Given that VB2 has now been implemented across all of our yards for approximately two years, we do not expect to continue to experience the same incremental favorable impact from VB2 that we have experienced in prior periods. Existing facilities contributed approximately \$15.6 million of the revenue growth and new facilities in or near Spokane, Washington; Tallahassee, Florida; Hialeah, Florida; Columbia, Missouri; Honolulu, Hawaii; Greenwood, Nebraska; Grand Island, Nebraska; York Haven, Pennsylvania; Chambersburg, Pennsylvania; Altoona, Pennsylvania; Fruitland, Maryland; Lansing, Michigan and Billings, Montana contributed approximately \$6.1 million of revenue growth.

Yard expenses were approximately \$80.0 million during the three months ended April 30, 2006, an increase of approximately \$11.2 million, or 16.3%, over the three months ended April 30, 2005. Yard expenses decreased to 53.5% of revenues during the three months ended April 30, 2006, as compared to 53.9% of revenues during the three months ended April 30, 2005. The increase in yard expenses were primarily attributable to the cost of handling increased volume, a general increase in subhauling costs and the incremental abnormal costs incurred as a result of Hurricanes Katrina and Rita. These additional inventory-type costs were approximately \$2.6 million in the three months ended April 30, 2006 and were charged to yard operations in accordance with SFAS 151. These costs include the additional subhauling, payroll, equipment and facilities expenses directly related to the operating conditions created by the hurricanes and will continue. These costs do not include normal expenses associated with the increased unit volume created by the hurricanes, which are deferred until the sale of the units and are recognized as vehicle pooling costs on the balance sheet. At the end of the quarter, approximately 64% of the incremental salvage vehicles received as a result of the hurricanes remained unsold and in inventory. We expect the majority of these vehicles to be sold primarily in the next two quarters. If the Gulf Coast region were to experience additional hurricanes or adverse weather conditions during the recently commenced hurricane season, we may be unable to sell the existing vehicles within the currently anticipated time frame, which may have an adverse effect on our operating results. The processing of the hurricane vehicles has had and may continue to have a negative impact on gross and operating margin percentages.

General and administrative expenses were approximately \$16.1 million during the three months ended April 30, 2006, an increase of approximately \$4.6 million, or 40.3%, over the three months ended April 30, 2005. The increase was primarily due to increases in telecommunication costs, information technology payroll costs, SFAS 123(R) stock compensation costs, outside legal expense associated with pending litigation and general corporate expansion. General and administrative expenses increased to 10.8% of revenues during the three months ended April 30, 2006, as compared to 9.0% of revenues during the three months ended April 30, 2005. The increase in general and administrative expenses as a percentage of total revenues reflects in part changes in the nature of our business. In particular, the introduction of VB2 resulted in a reduction in certain yard expenses but increased our general and administrative expenses as we continue to make technology infrastructure investments and hire additional personnel to enhance and maintain VB2 and other products for use in our auctions.

Total other income was approximately \$0.3 million during the three months ended April 30, 2006, a decrease of approximately \$1.6 million, from the three months ended April 30, 2005. The decrease was due primarily to a \$1.6 million equity method loss recognized from an equity investment in an unconsolidated privately-held entity. We expect to recognize additional equity method losses on this investment as the entity incurs development stage operating losses. This loss was offset by an increase in interest income of approximately \$0.6 million due to higher interest rates and a higher average cash balance. Other income, which consists primarily of rental income and gain on the sale of non fleet assets, decreased approximately \$0.6 million, resulting from a loss on disposal of fixed assets in the current quarter.

Our effective combined federal, state and local income tax rates for the three months ended April 30, 2006 and 2005 was approximately 38.2% and 37.8%, respectively.

During the three months ended January 31, 2006 we adopted a formal plan to discontinue the operations of our public auction business Motors Auction Group ( MAG ) and dispose of or convert the related assets. The MAG yards to be converted into salvage facilities will continue to be included in the results of continuing operations on the income statements. The assets of the MAG locations to be disposed of have been classified as assets held for sale in the balance sheets pursuant to Statement of Financial Accounting Standards (SFAS) No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets .

During the current quarter, we sold the business and related assets including the real estate of one of the MAG locations. We received a \$12 million promissory note from the buyer as purchase consideration. The promissory note bears interest at 7% per annum. Interest only payments on the note are due monthly until maturity on May 28, 2011. At maturity the balance of the note is due in full. The note receivable is collateralized by the real estate and is personally guaranteed by the buyer. The consideration was allocated to the real estate, based on an appraisal, and to the business in proportion to their estimated fair values. The portion of the consideration allocated to the real estate sale totaled \$7.1 million. We deferred a gain on the sale of the real estate of approximately \$2.5 million that will be recognized as we receive payments of principal on the \$7.1 million portion of the amount allocated to the real estate. The remaining consideration of \$4.9 million is allocated to the sale of the business. We recognized a gain on the sale of the business of approximately \$3.0 million, which is included in the results of the discontinued operations. As of April 30, 2006 two MAG locations remain, as two of the original six MAG locations were sold and two are being converted into salvage facilities.

Due to the foregoing factors, we realized net income of approximately \$34.7 million for the three months ended April 30, 2006, compared to net income of approximately \$30.9 million for the three months ended April 30, 2005.

***Nine Months Ended April 30, 2006 Compared to Nine Months Ended April 30, 2005***



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Revenues were approximately \$391.4 million during the nine months ended April 30, 2006, an increase of approximately \$54.2 million, or 16.1%, over the nine months ended April 30, 2005. The increase was due to increased vehicle sales volume and increased revenue per transaction driven by increased auction proceeds per vehicle. The increase in gross proceeds per vehicle (the gross sales price of the vehicle at auction) yields higher revenue per car as buyer fees and certain seller fees, including those sold under the PIP program are based on the gross proceeds per vehicle and generally increase as gross proceeds per vehicle grow. We believe the increase in recent periods in proceeds per vehicle has been largely attributable to VB2, which allows more buyers to participate in the auctions. Given that VB2 has now been implemented across all of our yards for approximately two years, we do not expect to continue to experience the same incremental favorable impact from VB2 that we have experienced in prior periods. Existing facilities contributed approximately \$40.8 million of the revenue growth and new facilities in or near Spokane, Washington; Tallahassee, Florida; Hialeah, Florida; Columbia, Missouri; Honolulu, Hawaii; Greenwood, Nebraska; Grand Island, Nebraska; York Haven, Pennsylvania; Chambersburg, Pennsylvania; Altoona, Pennsylvania; Fruitland, Maryland; Lansing, Michigan and Billings, Montana contributed approximately \$13.4 million of revenue growth.

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Yard expenses were approximately \$223.8 million during the nine months ended April 30, 2006, an increase of approximately \$37.4 million, or 20.1%, over the nine months ended April 30, 2005. Yard expenses increased to 57.2% of revenues during the nine months ended April 30, 2006, as compared to 55.3% of revenues during the nine months ended April 30, 2005. The increases in yard expenses were primarily attributable to the cost of handling increased volume, a general increase in subhauling costs and the incremental abnormal costs incurred as a result of hurricanes Katrina and Rita. These additional inventory-type costs were approximately \$12.0 million in the nine months ended April 30, 2006 and were charged to yard operations in accordance with SFAS 151. These costs include the additional subhauling, payroll, equipment and facilities expenses directly related to the operating conditions created by the hurricanes and will continue. These costs do not include normal expenses associated with the increased unit volume created by the hurricanes, which are deferred until the sale of the units and are recognized as vehicle pooling costs on the balance sheet. At the end of the quarter, approximately 64% of the incremental salvage vehicles received as a result of the hurricanes remained unsold and in inventory. We expect the majority of these vehicles to be sold primarily in the next two quarters. If the Gulf Coast region were to experience additional hurricanes or adverse weather conditions during the recently commenced hurricane season, we may be unable to sell the existing vehicles within the currently anticipated time frame, which may have an adverse effect on our operating results. The processing of the hurricane vehicles has had and may continue to have a negative impact on gross and operating margin percentages.

General and administrative expenses were approximately \$43.2 million during the nine months ended April 30, 2006, an increase of approximately \$11.3 million, or 35.2%, over the nine months ended April 30, 2005. The increase was primarily due to increases in telecommunication costs, information technology payroll costs, costs relating to Sarbanes-Oxley compliance, SFAS 123(R) stock compensation costs, outside legal expense associated with pending litigation and general corporate expansion. General and administrative expenses increased to 11.0% of revenues during the nine months ended April 30, 2006, as compared to 9.5% of revenues during the nine months ended April 30, 2005. The increase in general and administrative expenses as a percentage of total revenues reflects in part changes in the nature of our business. In particular, the introduction of VB2 resulted in a reduction in certain yard expenses but increased our general and administrative expenses as we continue to make technology infrastructure investments and hire additional personnel to enhance and maintain VB2 and other products for use in our auctions.

Total other income was approximately \$4.5 million during the nine months ended April 30, 2006, a decrease of approximately \$1.3 million, from the nine months ended April 30, 2005. The decrease was due primarily to a \$2.4 million equity method loss recognized from an equity investment in an unconsolidated privately-held entity. We expect to recognize additional equity method losses on this investment as the entity incurs development stage operating losses. This loss was offset by an increase in interest income of approximately \$2.4 million due to higher interest rates and a higher average cash balance. Other income, which consists primarily of rental income and gain on the sale of non fleet assets, decreased approximately \$1.2 million, resulting from a loss on disposal of fixed assets in the current quarter.

Our effective combined federal, state and local income tax rates for the nine months ended April 30, 2006 and 2005 was approximately 36.4% and 38.4%, respectively. The decrease in effective tax rate is primarily the result of recording a \$1.8 million out-of-period reduction to deferred tax liabilities and income tax expense originating primarily in 2001 and prior years during the prior quarter.

During the three months ended January 31, 2006 we adopted a formal plan to discontinue the operations of our public auction business Motors Auction Group ( MAG ) and dispose of or convert the related assets. The MAG yards to be converted into salvage facilities will continue to be included in the results of continuing operations on the income statements. The assets of the MAG locations to be disposed of have been classified as assets held for sale in the balance sheets as of January 31, 2006 and 2005 pursuant to SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets .

Under Statement of Financial Accounting Standard (SFAS) No 142, Goodwill and Other Intangible Assets, goodwill is subject to at least an annual assessment for impairment by applying a fair value-based test or on an interim basis if certain indicators are present. The discontinuation of an operating segment is one of those indicators. Accordingly, goodwill was tested for impairment in accordance with the provisions of SFAS No. 142 as of the second quarter of 2006. We used a combination of valuation techniques, which included consideration of market-based approaches and an income approach, in determining the fair value of our applicable reporting unit in the interim impairment test of goodwill.

The impairment test indicated that the carrying value of the MAG assets exceeded their implied fair values. The corresponding write-down of goodwill of \$21.8 million to its fair value was reported as a component of discontinued operations in the accompanying consolidated statements of income. We also determined that the value of the remaining MAG covenants not to compete were impaired and recorded an impairment expense in the amount of \$0.5 million. This write-down of covenants not to compete is also reported as a component of discontinued operations in the accompanying consolidated statements of income.



During the current quarter, we sold the business and related assets including the real estate of one of the MAG locations. We received a \$12 million promissory note from the buyer as purchase consideration. The promissory note bears interest at 7% per annum. Interest only payments on the note are due monthly until maturity on May 28, 2011. At maturity the balance of the note is due in full. The note receivable is collateralized by the real estate and is personally guaranteed by the buyer. The consideration was allocated to the real estate, based on an appraisal, and to the business in proportion to their estimated fair values. The portion of the consideration allocated to the real estate sale totaled \$7.1 million. We deferred a gain on the sale of the real estate of approximately \$2.5 million that will be recognized as we receive payments of principal on the \$7.1 million portion of the amount allocated to the real estate. The remaining consideration of \$4.9 million is allocated to the sale of the business. We recognized a gain on the sale of the business of approximately \$3.0 million, which is included in the results of the discontinued operations. As of April 30, 2006 two MAG locations remain, as two of the original six MAG locations were sold and two are being converted into salvage facilities.

Due to the foregoing factors, we realized net income of approximately \$65.4 million for the nine months ended April 30, 2006, compared to net income of approximately \$77.1 million for the nine months ended April 30, 2005.

### **Liquidity and Capital Resources**

Historically, we have financed our growth through cash generated from operations, public offerings of common stock, the equity issued in conjunction with certain acquisitions and debt financing. Cash and cash equivalents, combined with short-term investments decreased by approximately \$0.6 million from July 31, 2005 to April 30, 2006, as a result of cash used for acquisitions; purchases of property and equipment; an equity investment in an unconsolidated privately-held entity and repurchases of common stock. During the winter months, most of our facilities process 10% to 30% more vehicles than at other times of the year. This increased seasonal volume requires the increased use of our cash to pay out advances and handling costs of the additional business. Our primary source of cash generated by operations is from the collection of sellers' fees, buyers' fees and reimbursable advances from the proceeds of auctioned salvage vehicles.

As of April 30, 2006, we had working capital of approximately \$314.0 million, including cash, cash equivalents and short-term investments of approximately \$251.9 million. During the course of a quarter, we invest substantially all of our cash balances in AAA rated auction rate securities and typically convert a portion of these securities to cash and cash equivalents prior to the end of a quarter. Auction rate securities are principally variable rate securities tied to short-term interest rates with maturities on the face of the securities in excess of 90 days. Auction rate securities have interest rate resets through a modified Dutch auction, at predetermined short-term intervals, usually every 7, 28 or 35 days. They trade at par and are callable at par on any interest payment date at the option of the issuer. Interest paid during a given period is based upon the interest rate determined during the prior auction. Although these instruments are issued and rated as long-term securities, they are priced and traded as short-term securities because of the liquidity provided through the interest rate reset.

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

### ***Operating Activities***

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Net cash provided by operating activities decreased by \$10.7 million to \$92.4 million during the nine months ended April 30, 2006 when compared to the same period in fiscal 2005, due principally to the reduction in net income in 2006 and the timing of routine changes in working capital items. During the period we consumed cash through the growth in accounts receivable and vehicle pooling costs and we generated cash through the growth in deferred revenue. The movements in these accounts are driven primarily by the significant growth in vehicles held for sale which was impacted by the Hurrricanes Katrina and Rita. The decrease in net income is primarily a result of the loss on discontinued operations in the amount of \$19.3 million which was offset by increased revenue due to growth in vehicle sales volume, new service revenue and higher fees resulting from increased auction proceeds per vehicle.

### *Investing Activities*

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For the nine months ended April 30, 2006, we purchased approximately \$511.0 million in short-term investments. These purchases were partially offset by the sale of \$383.1 million of short-term investments. We typically invest our cash in auction rate notes with ratings of AAA.

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Capital expenditures (excluding those associated with fixed assets attributable to acquisitions) were approximately \$59.5 million and \$42.1 million for the nine months ended April 30, 2006 and 2005, 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 in order to handle increased volume and standardize the appearance of existing locations.

During the nine months ended April 30, 2006, we used cash for the acquisition of facilities in or near Billings, Montana; Fruitland, Maryland; Altoona, Pennsylvania; Chambersburg, Pennsylvania; York Haven, Pennsylvania; Greenwood, Nebraska and Grand Island, Nebraska, which had an aggregate cash cost of approximately \$22.9 million. During the nine months ended April 30, 2005, we used cash for the acquisition of one facility in or near Lexington, Kentucky which had an aggregate cash cost of approximately \$3.4 million.

During the nine months ended April 30, 2006, we invested \$9.0 million for a 50% equity investment in an unconsolidated privately-held development stage entity. We are not committed to provide any additional funding to this entity.

***Financing Activities***

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In February 2003, our Board of Directors authorized us to repurchase up to nine million shares of our common stock. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. The repurchases will be made at such times and in such amounts, as we deem appropriate and may be discontinued at any time. We repurchased 366,000 shares during the nine months ended April 30, 2006 at a weighted average price of \$24.24. We accounted for the repurchase of our common stock by reducing common stock for \$8.9 million. No shares were repurchased in fiscal 2005.

Net proceeds from the exercise of stock options were \$4.7 million and \$1.1 million for the nine months ended April 30, 2006 and April 30, 2005, respectively. We also recognized a tax benefit of \$1.2 million for the nine months ended April 30, 2006 associated with disqualifying dispositions of incentive stock options.

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

The following table summarizes our significant contractual obligations and commercial commitments as of April 30, 2006 (in thousands):

#### **Payments due by period**



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<b>Contractual obligations (1)</b>	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Capital leases	\$ 2	\$ 2	\$	\$	\$
Operating leases	\$ 119,071	\$ 23,030	\$ 34,303	\$ 24,643	\$ 37,095

**Amount of commitment expiration per period**

Commercial commitments (2)	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Letters of credit	\$ 9,000	\$ 9,000	\$	\$	\$

(1) Contractual obligations consist of long-term debt and future minimum lease payments under capital and operating leases, including off-balance sheet leases, used in the normal course of business.

(2) Commercial commitments include primarily letters of credit provided for insurance programs and certain business transactions.

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### *Credit Facilities*

On February 23, 2001, we entered into a credit facility with our existing banking syndicate. The facility provided by Wells Fargo Bank, Fleet National Bank and U.S. Bank National Association consists of an unsecured revolving reducing line of credit in the amount of \$10.6 million that matures in 2006. As of April 30, 2006, we had available \$10.5 million under this facility, after taking into account \$0.1 million of outstanding letters of credit. We are subject to customary covenants, including the following financial covenants: 1) ratio of funded debt to earnings before interest, taxes, depreciation and amortization (EBITDA); 2) profitable operation; 3) leverage ratio and 4) interest coverage ratio. We are in compliance with these covenants. On May 8, 2006 the remaining line of credit was reduced to zero and the line of credit was terminated in accordance with its terms.

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

Our principal exposures to financial market risk are interest rate and foreign currency risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio of marketable securities. As of April 30, 2006, our cash, cash equivalents and short-term investments consisted primarily of funds invested in money market accounts, which bear interest at a variable rate and AAA rated auction rate securities, which also bear interest at a variable rate. Due to the average maturity and nature of the Company's investment portfolio, we believe a sudden change in interest rates would not have a material effect on the value of our investment portfolio. As the interest rates on a material portion of our cash, cash equivalents and short-term investments are variable, a change in interest rates earned on our investment portfolio would impact interest income along with cash flows, but would not materially impact the fair market value of the related underlying instruments.

Our exposure to foreign currency risks relates to our operations in Canada, which has not been significant. We do not hedge our exposure to the Canadian dollar. We do not use derivative financial instruments for speculative or trading purposes.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### (a) Evaluation of Disclosure Controls and Procedures

Our management evaluated, with participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

#### (b) Changes in Internal Controls

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

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are involved in litigation and damage claims arising in the ordinary course of business, such as actions related to injuries, property damage, handling or disposal of vehicles and patent infringement. We are also involved in various governmental and administrative proceedings primarily relating to licensing and operation of our business. Among this litigation is a lawsuit filed by Ciano Dessources on May 21, 2003 in the Commonwealth of Massachusetts, Superior Court Department against Copart of Connecticut, Inc. and Copart, Inc., which purports to be a class action on behalf of persons whose vehicles were disposed of by us as abandoned vehicles, and which the named plaintiff contends were disposed of without complying with state laws. Relief sought included class certification, declaratory, remedial and/or injunctive relief, including the ordering of a compliance program that will essentially protect consumers, as well as damages, fees, and costs. Copart's Motion for Summary Judgment was granted on December 8, 2004, dismissing the class claim element of the lawsuit. However this dismissal may be reconsidered, and may also be appealed once the remaining individual claims of the named plaintiff are adjudicated.

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

On September 16, 2005, Richard M. Gray filed suit against Copart and A. Safrin, in the State Court for the County of Chatham, State of Georgia, alleging a class action for unreasonable amounts claimed for storage liens by Copart, and related claims. Relief sought included class certification, damages, fees, costs and expenses. On October 20, 2005 we denied the claims and on May 12, 2006 we filed a motion for summary judgment. No trial date has been set.

We provide for costs relating to these matters when a loss is probable and the amount can be reasonably estimated. The effect of the outcome of these matters on our future results of operations cannot be predicted because any such effect depends on future results of operations, and the amount and timing of the resolution of such matters. We believe that any ultimate liability will not have a material effect on our financial position, results of operations or cash flows. However, the amount of the liabilities associated with these claims, if any, cannot be determined with certainty.

### ITEM 1A. RISK FACTORS

**We have listed below various risks and uncertainties relating to our businesses. This list is not inclusive of all the risks and uncertainties we face, but any of these could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this report or that we may issue from time to time in the future.**

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

Historically, a limited number of vehicle suppliers have accounted for a substantial portion of our revenues. In the third quarter of fiscal 2006, vehicles supplied by our two largest suppliers accounted for approximately 23% of our revenues. Supplier arrangements are either written or oral agreements typically subject to cancellation by either party upon 30 to 90 days notice. Vehicle suppliers have terminated agreements with us in the past in particular markets, which has affected the pricing for sales services in those markets. There can be no assurance that our existing agreements will not be cancelled. Furthermore, there can be no assurance that we will be able to enter into future agreements with vehicle suppliers or that we will be able to retain our existing supply of salvage vehicles. A reduction in vehicles from a significant vehicle supplier or any material changes in the terms of an arrangement with a substantial vehicle supplier could have a material adverse effect on our financial position, results of operations or cash flows. In addition, a failure to increase our sources of vehicle supply could adversely affect our earnings and revenue growth rates.

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

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

- Our operating results in a particular period could be adversely affected in the event our networks are not operable for an extended period of time for any reason, as a result of Internet viruses, or as a result of any other technological circumstance that makes us unable to conduct our virtual sales.
- Our business is increasingly reliant on internally developed technology, and we have limited historic experience developing technologies or systems for large-scale implementation and use.
- The change in our business model may make it more difficult for management, investment analysts, and investors to model or predict our future operating results until sufficient historic data is available to evaluate the effect of the VB2 implementation over a longer period of time and in different economic environments.
- Our increasing reliance on proprietary technology subjects us to intellectual property risks, including the risk of third party infringement claims or the risk that we cannot establish or protect intellectual property rights in our technologies. We have filed patent applications for VB2 in the United States, Netherlands, and Europe, but we cannot provide any assurances that patents will actually issue or that, if issued, the patent could not later be found to be unenforceable or invalid. In June 2005, Manheim Services Corp. filed suit against us in federal district court in Georgia, alleging, among other things, that VB2 infringes a patent assigned to Manheim. We intend to defend the lawsuit vigorously, but an adverse ruling, settlement, or judgment, could have a material adverse effect on our financial condition and results of operation.

**Our operating results were adversely affected by abnormal expenses associated with Hurricanes Katrina and Rita during the three and nine months ended April 30, 2006, and our operating margins in future periods could continue to be adversely affected by the hurricanes.**

During the three and nine months ended April 30, 2006, we recognized substantial additional costs associated with Hurricanes Katrina and Rita. These additional costs, characterized as abnormal under FAS 151, were recognized during the three and nine months ended April 30, 2006, and include the additional subhauling, payroll, equipment, and facilities expenses directly related to the operating conditions created by the hurricanes. We expect these costs to continue in future periods. These abnormal costs do not include the normal expenses associated with the increased unit volume created by the hurricanes, which are deferred until the sale of the unit and are reflected in vehicle pooling costs on the balance sheet. As of April 30, 2006, approximately 64% of the incremental salvage vehicles received as a result of the hurricanes remained unsold and in inventory. The Company expects that the majority of these vehicles to be sold primarily in the next two quarters. The Company's expectation that we will sell the balance of the unsold hurricane-related vehicles primarily within the next two quarters is based on management's current expectations, which assumes, among other things, that the Gulf Coast region will not experience additional adverse weather events, including any additional hurricanes as we enter the 2006 hurricane season. The normal costs that have been capitalized will be recognized as yard expense as the vehicles are sold. Legislation recently enacted in Louisiana will require that vehicles suffering water damage to the powertrain, computer, or electrical systems as a result of the hurricanes can only be dismantled or crushed. As a result, this legislation could have an adverse effect on selling prices for vehicles received from Louisiana as a result of the hurricanes, which could have an adverse effect on our margins until the hurricane damaged vehicles are sold.

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

We believe that the implementation of our proprietary VB2 sales technologies across our salvage operations has had a favorable impact on our results of operations by increasing the size and geographic scope of our buyer base and increasing the average selling price for vehicles sold through our sales. VB2 was implemented across all our salvage yards beginning in the third quarter of fiscal 2004. We do not believe, however, that we will continue to experience improvements in our results of operations at the same relative rates we have experienced in the last year.

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

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

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

Mild weather conditions in the United States tend to result in a decrease in the available supply of salvage vehicles because traffic accidents decrease and fewer automobiles are damaged. Accordingly, mild weather can have an adverse effect on our salvage vehicle inventories, which would be expected to have an adverse effect on our revenue and related growth rates and could have an adverse effect on our operating results. Conversely, our inventories will tend to increase in poor weather such as a harsh winter or as a result of adverse weather-related conditions such as flooding. During periods of mild weather conditions, our ability to increase our revenues and improve our operating results and related growth will be increasingly dependent on our ability to obtain additional vehicle suppliers and to compete more effectively in the market, each of which is subject to the other risks and uncertainties described in these sections.

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

Significant increases in the cost of fuel could lead to a reduction in miles driven per car and a reduction in accident rates. A material reduction in accident rates could have a material impact on revenue growth. In addition, under our PIP contracts the cost of towing the vehicle to one of our facilities is included in the Percentage Incentive Program fee. We may incur increased fees which we will not be able to pass on to the insurance companies. A material increase in tow rates could have a material impact on our operating results.

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

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

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



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

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

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

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

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

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

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

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

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

- fluctuations in the market value of salvage and used vehicles;
- the availability of salvage vehicles;
- variations in vehicle accident rates;
- buyer participation in the Internet bidding process;
- delays or changes in state title processing;

- changes in state or federal laws or regulations affecting salvage vehicles;
- changes in state laws affecting who may purchase salvage vehicles;
- our ability to integrate and manage our acquisitions successfully;
- the timing and size of our new facility openings;
- the announcement of new vehicle supply agreements by us or our competitors;
- severity of weather and seasonality of weather patterns;
- the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our business, operations and infrastructure;
- the availability and cost of general business insurance;

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- labor costs and collective bargaining;
- availability of subhauers at competitive rates;
- acceptance of buyers and sellers of our Internet-based model deploying VB2, a proprietary Internet auction-style sales technology;
- current levels of out of state and foreign demand for salvage vehicles may not continue;
- the introduction of a similar Internet product by a competitor; and
- the ability to obtain necessary permits to operate salvage storage facilities.

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

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

Implementation of VB2 across our salvage operations has increased the relative importance of intellectual property rights to our business. Our intellectual property rights include pending patent applications for VB2 as well as trademarks, trade secrets, copyrights and other intellectual property rights. We are in the process of prosecuting an initial patent application relating to VB2 and cannot predict whether a patent will actually issue from that application. Even if a patent is issued, the scope of the protection gained may be insufficient or any issued patent could subsequently be deemed invalid or unenforceable. In addition, we are increasingly entering 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 are, and may in the future be, subject to intellectual property rights claims, which are costly to defend, could require us to pay damages, and could limit our ability to use certain technologies in the future.**

Litigation based on allegations of infringement or other violations of intellectual property rights are common among companies who rely heavily on intellectual property rights. Our reliance on intellectual property rights has increased significantly in recent years as we have implemented our VB2 auction-style sales technologies across our business and abandoned live auctions. As we face increasing competition, the possibility of intellectual property rights claims against us grows. In June 2005, a competitor filed a patent infringement claim against us relating to our VB2 technologies. This litigation and any other intellectual property claims, whether with or without merit, can be time-consuming, expensive to litigate and settle, and can divert management resources and attention from our core business. An adverse determination in current or future litigation could prevent us from offering our products and services in the manner currently conducted. We may also have to pay damages or seek a license for the technology, which may not be available on reasonable terms and which may significantly increase our operating expenses, if it is available for us to license at all. We could also be required to develop alternative non-infringing technology, which could require significant effort and expense.

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

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

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

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

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

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

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

We rely upon independent subhaulers to pick up and deliver vehicles to and from our storage facilities. Our failure to pick up and deliver vehicles in a timely and accurate manner could harm our reputation and brand, which could have a material adverse effect on our business. Further, an increase in fuel cost may lead to increased prices charged by our independent subhaulers, which may significantly increase our cost. These costs may not be passed on to our sellers or buyers.

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

We are partially self-insured for certain losses related to medical, general liability, workers' compensation and auto liability. Our liability represents an estimate of the ultimate cost of claims incurred as of the balance sheet date. The estimated liability is not discounted and is established based upon analysis of historical data and actuarial estimates. While we believe these estimates are reasonable based on the information currently available, if actual trends, including the severity of claims and medical cost inflation, differ from our estimates, our financial position, results of operations or cash flows, could be impacted. 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. If these actuaries provide guidance based on erroneous assumptions, use models mathematically flawed or otherwise provide advice that is inaccurate or unrepresentative, then it could have an adverse impact on our financial position, results of operations or cash flows.

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

Our executive officers, directors and their affiliates beneficially own, in the aggregate, approximately 24% of our common stock as of April 30, 2006. If they were to act together, these shareholders would have significant influence over most matters requiring approval by shareholders, including the election of directors, any amendments to our articles of incorporation and certain significant corporate transactions, including potential merger or acquisition transactions. In addition, without the consent of these shareholders, we could be delayed or prevented from entering into transactions that could be beneficial to us or our other investors. These shareholders may take these actions even if they are opposed by our other investors.



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

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

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

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

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

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

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

The following table sets forth information regarding the Company's repurchases of its Common Stock during fiscal 2006:

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

(a) In February 2003, the Company's Board of Directors authorized the Company to repurchase up to nine million shares of its Common Stock. The repurchases may be effected through solicited or unsolicited transactions in the open market or in privately negotiated transactions. No time limit has been placed on the duration of the share repurchase program. The repurchases will be made at such times and in such amounts, as the Company deems appropriate and may be discontinued at any time.





**ITEM 6. EXHIBITS**

(a) Exhibits

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

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**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 8, 2006

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