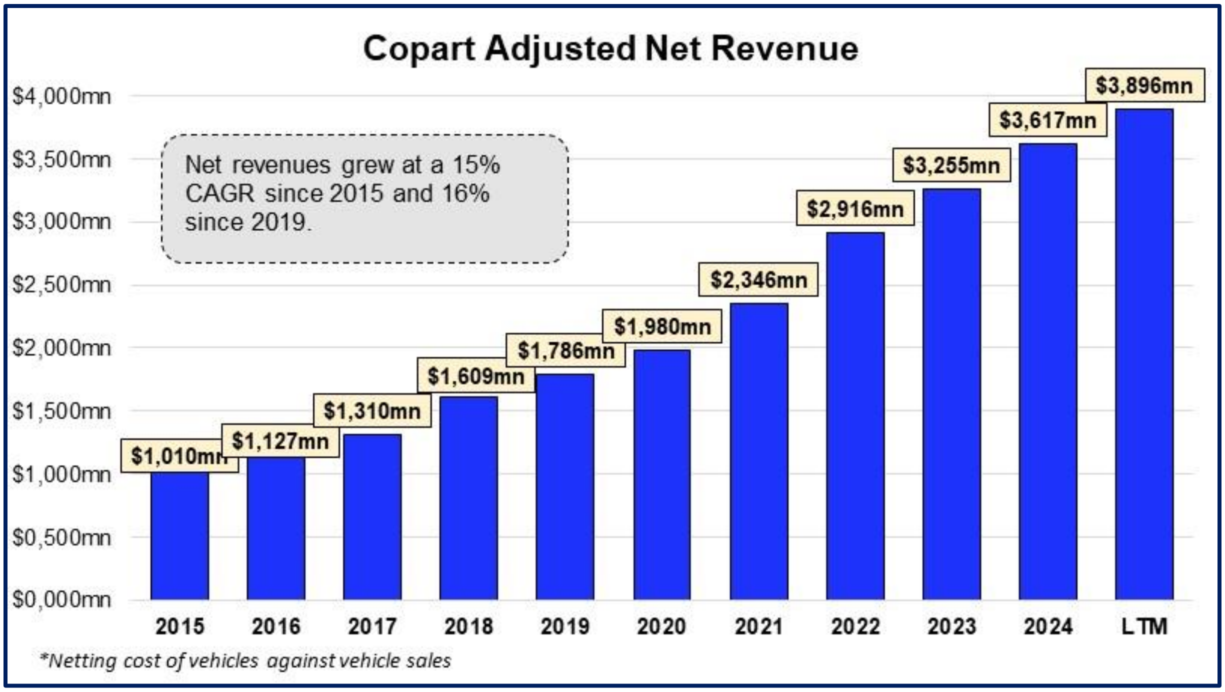
Copart reported another strong quarter, showing progress on their international efforts while continuing to (somehow) further entrench their dominance in the U.S. market.

Copart's service revenues increased +15% y/y and vehicle sales increased +9% y/y.

We prefer to look at Copart on an adjusted net revenue basis because of the distortions the vehicles sales line item brings. As a reminder, this is because they sometime purchase vehicles and resell them (primarily in their international operations as they are proving out a market). This creates a large revenue impact because the full sale price of the vehicle is recorded as revenue instead of just the commission, as is with their "service revenue". Our adjusted net revenue figure takes their total revenues and nets it against vehicle COGS for a better comparison of the economics of their transactions.

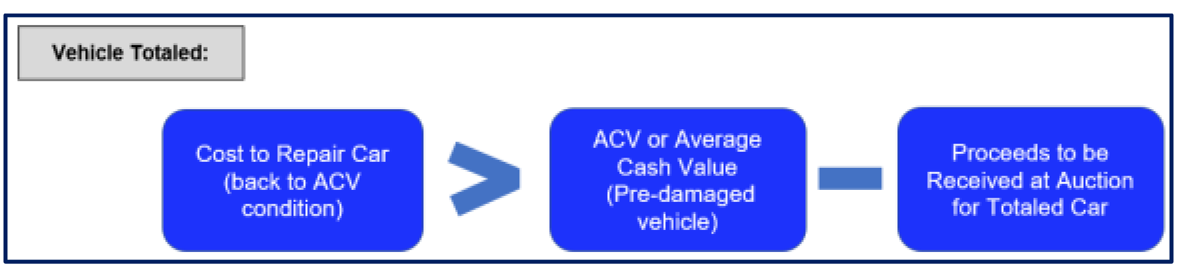
Adjusted net revenues were +16% y/y, bringing them to a touch over $1bn for the quarter. This is about the same growth rate as last quarter and in line with their past ~5 year growth rate and slightly higher than their 10 year CAGR.



Copart continues to benefit from several trends: **1)** rising total loss frequency, **2)** a slight shift towards higher quality cars, and **3)** international markets moving to a consignment model, shaped by Copart's entrance.

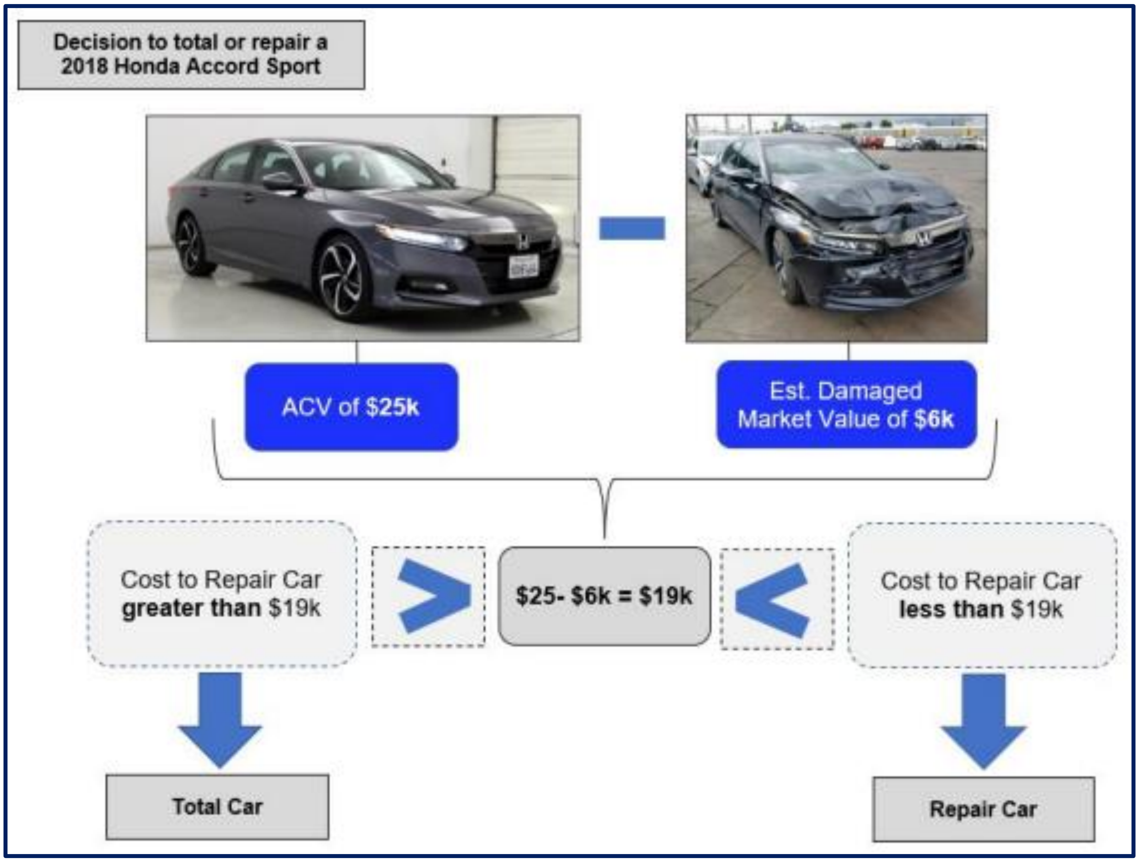
Total loss frequency has been increasing because repair costs have been ballooning as vehicle complexity grows. The more wiring, sensors, and "smart" parts means that even a small accident can require replacing a lot of delicate technology and a computer system reset. Whereas fixing a bumper used to be a simple a plopping off the old one and throwing on a new one, now a bumper may have a dozen sensors that are all intricately wired deep into the vehicle.

The increase in repair cost means insurance companies are more likely to total a car, rather than pay to repair it. The insurance company's decision to total a vehicle is simply the outcome of the equation below. If the cost to repair the vehicle is more than the cost to buy a similar vehicle less the proceeds they get for the damaged one, they total it.



From our Copart Extensive Research Report.

Their willingness to total vehicles is also supported by the fact that it generally leads to higher customer satisfaction as a badly damaged car is usually never the same as it was pre-accident. The offset of insurance companies being far more ready to total vehicles is higher auto premiums, which means the insurance company is generally indifferent to the rate of cars totaled.



From our Copart Extensive Research Report.

The other aspect of this is that access to international markets has only grown recently and countries do not have as strong regulations as in the United States, which requires inspection before registering a previously salvaged vehicle. So, there is an element that damaged cars are worth more in unregulated international markets, since they do not have to undergo inspection and can be used without certain repairs (not replacing a used airbag or broken door for example).

20 years ago a totaled car may be one that would be impossible to ever drive, whereas now cars are regularly totaled that can still drive. A side effect of this has meant that Copart's vehicle mix shift has been tilting more towards higher end vehicles. (Remember, "higher end" is relative to literal junkyard cars).

Separate from this dynamic has been a conscious push by Copart with their "Blue Car" initiative to move more into "whole car", which just means functioning vehicles. These car tend to come from bank repossessions, rental fleets, as well as their direct to consumer channels such as Cash For Cars. The ever so slow move upmarket has been a multi-year tailwind for Copart and could in the future position them to go after whole car more directly, similar to their 2005 "Motors Auction Group" initiative.

> But as total loss frequency rises and the cars we sell increasingly are almost not recognizable as totaled, in some cases, you could not tell by the naked eye that the car had even been in an accident. The universe of buyers for those vehicles begins to very heavily resemble the buyers of cars at traditional auto auctions, wholesale auto auctions.
>
> So that trend continues in our favor. So the liquidity pool that Copart provides just organically extends into that space more and more. Broadly speaking, as you, I'm sure, are well aware, the wholesale auction intermediated market is no worth of 15 million cars a year, some of those cars, of course, sell for $30,000, $40,000 plus.
>
> Those aren't yet our sweet spot. But as for the cars that are in the insurance zone, so to speak, we are talking many, many, many cars. We should be in the early innings of our experience there. And we have invested in a sales force as you know. Our aspiration is to invest far more over the years to come. Both as our capabilities grow, the auction liquidity continues to move in that direction, and we've become a still more credible provider of those services to sellers in that universe.
>
> - Jeff Liaw, Copart CEO, 4Q24 Earnings Call

The vehicle quality tailwind means higher ASPs and thus gross profit per vehicle (note this is different from the discussion of pricing vs volume they typically have on the call because that is in the context of ACV's impact on the insurers decision to total).

Separately, Copart is also benefiting from success with their international operations. As CFO Leah Stearns noted on the call, "the reduction in international purchased vehicle revenue accompanied by an increase in gross margin continues to be driven by higher ASP insurance vehicles in Germany, which have transitioned from a purchase contract to a consignment model as well as stronger purchase unit margins in the U.K."

It is a little wild to think that Copart entered the Germany market in 2012 and only really in the past year or two have we started to see some proof points of them transitioning the insurance industry into the commission model. (See our report for an explanation of how the Germany insurance market historically worked). Total growth in international units increased +7% y/y excluding CAT events.

While they don't explicitly talk about it, mathematically they must be increasing their revenue per vehicle sold, charging insurance companies for the extra services they continue to add like Title Express. While this is an imprecise calculation, if total global units sold was +8% y/y and ASPs were +2%, the difference to get to +15% y/y service revenue growth is increasing fees per vehicle handled. This can either be an increase in price or an increase in the numbers of services sold. Our assumption would be that is primarily the latter.

This leaves the question of how many more services can Copart insource from the insurance companies? On the call they gave one clue with the inefficiencies from tow yards where the vehicle usually moves to a local city lot, incurring fees, before the insurance company knows about the accident, let alone whether it is a total or not. The sooner Copart can interject themselves after an accident, the less money an insurance company will waste.

All of these growth initiatives do show up on the P&L via operating margin compression of about 200bps y/y for the first half of fiscal 2025 (Or 4Q24 and 3Q24 on a calendar year).

CEO Jeff Liaw had a pretty incredible quote (below) on incurring short-term expenses for long-term gains, which is exactly how you want a manager to respond when they are thinking about building a business for the decades to come.

> We want to invest in the business to grow it. I wouldn't read into any given quarter. And that goes for CapEx and G&A and so forth. We're not managing for the smoothness of our earnings, we manage to grow the enterprise profitably for the benefit of our customers and our shareholders long term. So the quarterly blips, there's some seasonality in the business invariably and yard expenses, there's some variability in G&A for projects or what have you. And we undertake no efforts to smooth them whatsoever, right? So they are what they are, look to multiple quarters to draw any conclusions.
>
> \- Jeff Liaw, Copart CEO, 4Q24 Earnings Call

After our call notes below we will move onto valuation.

Call Notes.

Insurance Volume

- “Continue to grow our insurance volume, our auction liquidity and the returns we're generating for our sellers.“

- **Insurance carriers are trusting us with more of the workflow they used to handle in-house**
    - "One very visible example, now that we are processing well over 1 million titles per year via our Title Express platform, **no carrier who has started with Copart has taken it back in-house."**
- Insurance business global volume grew +8% y/y
    - Half was attributable to the catastrophic events in the second half of last year.
- US Insurance grew +9% y/y or +2% y/y excluding CAT volume
- Noninsurance unit volume increases outpaced insurance volume growth, excluding CAT
    - "**Blue Car**, which services our bank, rents and fleet customers, continued its strong trend with growth of over **+27% y/y**"
    - "**Low-value units, including charities and municipalities, declined just over 4% as we continue to focus on higher margin per unit business lines.**"

Expansion Beyond Insurance Volume

- "Expansion of our business with sellers beyond the insurance industry to include financial institutions, rental car fleets, corporate fleets, among others"

Total Loss Frequency

- **Total loss frequency hit 23.8%, an all-time high** for the fourth quarter in the United States
    - Partly influenced by CAT event
- "**Repairing cars becomes less attractive as time passes as labor cost increase, repair, parts cost increase and rental car rates do as well, while totaling vehicles becomes more attractive given the liquidity of our auctions, demand for our vehicles by international buyers and the salvage returns we're able to generate for our sellers**."

International

- International fee units increased +11% y/y and purchase units decreased 6% for the quarter.
- "As a reminder, the reduction in international purchased vehicle revenue accompanied by an increase in gross margin continues to be driven by higher ASP insurance vehicles in Germany, which have transitioned from a purchase contract to a consignment model as well as stronger purchase unit margins in the U.K."

Tariffs

- "**It's frankly similar to an inquiry that we get from time to time about whether high used car prices or low used car prices are better for our business. The reality is that we're somewhat ambivalent**."
- "The bottom line of a potential tariff-oriented approach would be that it's **largely neutral to our business**"
- "**Inbound tariffs in isolation would increase the cost of repair parts for vehicles**, which all else equal, would **increase total loss frequency** and drive increased volume to Copart. Inbound tariffs, however, **would also increase pre-accident values** or actual cash values to use the American parlance , which in isolation would **increase the cost of total losses to insurance carriers, reducing total loss frequency and suppressing volume to Copart**. But those inbound tariffs would also increase the selling prices for the vehicles that we sell at auction for the very same reason, yet again, driving total loss frequency up and improving our unit economics as well.

  If the story is stopped there, I'd characterize the effect of tariffs as being modestly positive to Copart. **The great unknown, however, is what inbound tariffs for shipments to the United States, whether those tariffs could precipitate retaliatory tariffs from the same countries against whom we are imposing them**.

  The countries that would face the **most substantial tariff burdens such as Germany, Japan, Mexico and Canada are generally not the providers of critical high-value liquidity for our auctions**. Those nations are typically in Eastern Europe, the Middle East and Africa, as has been true now for many years**,** economic outcomes for our sellers and for Copart at **our auctions are largely driven by the cars that we are selling as repairable drivable cars, not as parts** to be harvested nor as metal to be scrapped. The countries who **are hungriest for these types of cars generally do not have substantial domestic auto manufacturing capabilities** and as such, are **not likely to be subject to significant automotive tariffs** against which to retaliate in the first place.

  That's a bit of a long-winded answer. But in sum, I think we believe the tariffs would have a likely **neutral to modestly positive effect** on our business."

Purple Wave

- +8% y/y GTV growth
- "2 components to our expansion of the Purple Wave sales force. One is densification of sales professionals in the existing territories that Purple Wave was

operating in prior to our investment. And the second is to identify the markets where the highest volume of transactions occur and identify seasoned professionals to join the team to help expedite our ability to win share in those markets. "

  - **Densify our sales force** in some Purple Wave legacy markets, and that's helping win more share in those markets as well

- "The team has built a strong virtual auction business for the heavy equipment space. So they have, by and large, not relied on physical stores. So even as we expand into new geographic adjacencies, the investment is largely people and systems oriented as opposed to large storage facilities or large physical infrastructure."

Key Friction Point

- Initial tow usually happens without insurance companies knowledge. This tow and the storage is costly.
  - **Quicker alert of accident can help them assess total loss quicker and properly direct the vehicle with less touch points**
- **Addressing outstanding liens** with a fractioned lender base

Valuation.

Copart's TTM EPS is about $1.50, which at today's stock price of $57 is 38x earnings. Growing earnings at a low teens rate, means it will take about 4-5 years for Copart to reach a current market multiple. This means that if an investor believes Copart is better than a market average business, they need to have high confidence these next ~5 years of growth will happen in order for them to potentially find this investment attractive (this would be on a relative, not absolute basis. See this memo for more).

Copart Snap Shot				
Market Valuation (NASDAQ: CPRT)				
Market Cap	**$55.7bn**		**Enterprise Value**	**$52.1bn**
Diluted S/O	*978mn*		Debt	0.1bn
Stock Price	**$57**		Cash	3.8bn
			Net Cash	3.7bn

Another way we can look at Copart is on a free cash flow basis, stripping out growth capex. There is some helpful commentary early in Copart's history that can help us make this distinction. As we noted in our prior Copart update:

> We consider D&A to be a fair, if not overstated, estimate of maintenance capex… In 4Q04 they disclosed that maintenance capex would be $10-15mn for 2005, whereas D&A was twice that. This comes out under 25% of total capex for the year being categorized as maintenance capex. A salvage operation requires very minimal non-recurring capex for upkeep and would seldom require a remodel or refresh like retail stores commonly do.
>
> As Copart is a larger organization today than they were back then, we can expect a larger portion of overall capex to be directed to maintenance capex. We assume that D&A is equal to maintenance capex, which means that about 35% of capex is spent on maintenance.
>
> Frankly, this is probably an overestimate as they run literal junk yards, so there is almost zero need to for upkeep. However, there is tech spend and equipment that needs to be periodically updated. With over 250 yards today and our estimated maintenance capex budget of about $220mn, that comes out to over $750k per yard, which seems more than reasonable.

We take TTM free cash flow (excluding SBC) and then add back capex, but subtract out D&A to get a better sense of what "owners earnings" would be—that is cash earnings an owner of this business could take out if they were not investing in growth. This figure for Copart today is about $1.35bn. At today's enterprise value, that is a free cash flow yield of 2.6% or a 39x adjusted FCF multiple.

A third way we can look at Copart is with the reverse DCF. We ran this last quarter at a stock price of $60 and didn't re-run it since the difference in return will be inconsequential.

We sensitized around a 7-16% revenue growth rate assumption.

Reverse DCF Assumptions					
Revenue Growth Assumptions per Period					
	Period	Y1-Y5	Y6-Y10	Y11-Y20	After Y20
Scenario Label	**7%**	7%	5%	4%	3%
	10%	10%	8%	6%	3%
	13%	13%	10%	7%	3%
	16%	16%	13%	9%	3%

Capex as a % of OCF is currently about 50%, but has averaged 42% since 2015. As they continue to grow, capex as a % of OCF could fall as there are fewer growth opportunities, but the exact amount will be a key question for Copart's long-term growth potential. We will sensitize this figure around 30-45%. When looking at the reverse DCF outputs, an investor should assume a higher rate of capex if they are gravitating toward the higher growth scenarios.

Reverse DCF Assumptions					
Reinvestment Rate Assumptions per Period					
	Period	Y1-Y5	Y6-Y10	Y11-Y20	After Y20
Scenario Label	**45%**	45%	35%	25%	10%
	40%	40%	30%	20%	10%
	35%	35%	25%	15%	10%
	30%	30%	20%	15%	10%

The outputs of our reverse DCF are shown below. The outputs show what return an investor would earn if they theoretically owned the entire company and were returned all excess cash flows. For example, the highlighted returns are what an investor would earn if Copart grew 10-13% for the next 5 years, with growth fading thereafter, and invested 35-40% of all operating cash flow back into the business.

Reverse DCF Outputs					
Growth Rate Scenario		7%	10%	13%	16%
Reinvestment Rate Scenario	45%	6.2%	7.5%	8.6%	10.2%
	40%	6.3%	7.6%	8.7%	10.4%
	35%	6.4%	7.7%	8.9%	10.6%
	30%	6.4%	7.8%	8.9%	10.7%

It is up to each investor to decide what return they are seeking and how much risk they want to accept to potentially earn that. Some investors may be of the opinion that a particularly high quality company may be worth accepting a lower prospective return for because they view the left-tail (downside) risk to be more minimal.

Conversely, another investor may believe that a high quality company tends to do things that the investor cannot easily anticipate and thus will accept a lower return from the numbers they can conservatively calculate, thinking that a new initiative or upside surprises could make up the difference. Copart's Blue Car and a continued climb to higher quality cars, or Purple Wave gaining dominance, could be such value creating scenarios that are hard to "believe" at the outset. These investors may think of their return in two "buckets": **1)** a return that is above the risk-free rate (treasuries), but is low compared to historical market returns, and **2)** a call option on other value creation opportunities. On the other hand, a lose discipline with the returns an investor is willing to accept on conservative assumption can also end in tears.

We named our research firm Speedwell after the ship that helped ferry passengers to the Mayflower. The idea is that we want to help you get into the position to take the journey, but ultimately, we are not going to go with you. There should be no illusions—you are on your own with the decisions you make. It is an investors job to judge for themselves whether they believe the potential for profits are worth the potential risks that could materialize.

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