

DealerTrack Holdings, Inc.  
Form 10-Q  
August 11, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**Form 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the quarterly period ended June 30, 2006**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**Commission File Number 000-51653**  
**DealerTrack Holdings, Inc.**  
**(Exact name of Registrant as specified in its charter)**

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

**52-2336218**  
(I.R.S. Employer Identification Number)

**1111 Marcus Ave., Suite M04**  
**Lake Success, NY**  
(Address of principal executive offices)

**11042**  
(Zip Code)

Registrant's telephone number, including area code: **(516) 734-3600**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2.)

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 ☒

As of July 31, 2006, 36,741,074 shares of the registrant's common stock were outstanding.

**DEALERTRACK HOLDINGS, INC.**  
**FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006**  
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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**DEALERTRACK HOLDINGS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(unaudited)**

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
	<b>(In thousands, except share and per share amounts)</b>	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 25,519	\$ 103,264
Short-term investments	60,500	
Accounts receivable related party	7,037	5,386
Accounts receivable, net of allowances of \$3,801 and \$2,664 at June 30, 2006 and December 31, 2005, respectively	14,107	13,893
Prepaid expenses and other current assets	4,143	3,902
Deferred tax asset	910	910
Total current assets	112,216	127,355
Property and equipment, net	6,220	4,885
Software and website developments costs, net	11,530	8,769
Intangible assets, net	44,850	39,550
Goodwill	49,216	34,200
Restricted cash	540	590
Deferred taxes and other long-term assets	8,389	5,266
Total assets	\$ 232,961	\$ 220,615

**LIABILITIES AND STOCKHOLDERS EQUITY**

Current liabilities		
Accounts payable	\$ 915	\$ 2,367
Accounts payable related party	177	2,021
Accrued compensation and benefits	6,104	7,589
Accrued other	10,588	8,674
Deferred revenue	3,634	3,267
Deferred taxes	42	42
Due to acquirees	1,851	1,447
Capital leases payable	144	387
Total current liabilities	23,455	25,794
Capital leases payable long-term		7
Due to acquirees long-term	4,043	4,957
Other long-term liabilities	5,414	3,186

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Total liabilities	32,912	33,944
Commitment and contingencies (Note 10)		
Stockholders' equity		
Preferred stock, \$0.01 par value; 10,000,000 shares authorized and no shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively		
Common stock, \$0.01 par value; 175,000,000 shares authorized; 35,761,812 and 35,379,717 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively		
	358	354
Additional paid-in capital	218,070	214,471
Deferred stock-based compensation	(6,162)	(7,745)
Accumulated other comprehensive income (foreign currency)	258	157
Accumulated deficit	(12,475)	(20,566)
Total stockholders' equity	200,049	186,671
Total liabilities and stockholders' equity	\$ 232,961	\$ 220,615

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

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**DEALERTRACK HOLDINGS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except share and per share amounts)</b>		<b>(In thousands, except share and per share amounts)</b>	
<b>Revenue</b>				
Net revenue(1)	\$ 43,414	\$ 29,193	\$ 81,349	\$ 52,464
<b>Operating costs and expenses</b>				
Cost of revenue(1)(2)	17,289	11,786	32,408	20,189
Product development(2)	2,361	1,320	4,563	2,087
Selling, general and administrative(2)	16,474	13,911	32,443	24,396
Total operating costs and expenses	36,124	27,017	69,414	46,672
Income from operations	7,290	2,176	11,935	5,792
Interest income	785	33	1,748	86
Interest expense	(69)	(333)	(141)	(373)
Income before provision for income taxes	8,006	1,876	13,542	5,505
Provision for income taxes, net (3)	(3,351)	(808)	(5,451)	(2,368)
Net income	\$ 4,655	\$ 1,068	\$ 8,091	\$ 3,137
Basic net income per share applicable to common stockholders(4)	\$ 0.13	\$ 0.04	\$ 0.23	\$ 0.12
Diluted net income per share applicable to common stockholders(4)	\$ 0.13	\$ 0.02	\$ 0.22	\$ 0.07
Weighted average shares outstanding	35,402,769	633,975	35,335,493	567,302
Weighted average shares outstanding assuming dilution	36,933,366	1,261,611	36,878,342	1,052,763

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
(1) Related party revenue	\$ 11,067	\$ 7,219	\$ 20,319	\$ 13,371
Related party cost of revenue	962	894	1,809	1,676

(2) Stock-based compensation expense recorded for the three and six months ended June 30, 2006 and 2005 was classified as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Cost of revenue	\$ 271	\$ 61	\$ 524	\$ 108
Product development	90	23	168	40
Selling, general and administrative	1,036	313	1,929	517

(3) Refer to Note 2 of these consolidated financial statements.

(4) See Note 2 of these consolidated financial statements for earnings per share calculations.

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

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**DEALERTRACK HOLDINGS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities</b>		
Net income	\$ 8,091	\$ 3,137
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	12,239	8,613
Deferred tax (benefit) provision	(2,548)	661
Amortization of stock-based compensation	2,621	665
Provision for doubtful accounts and sales credits	2,321	1,441
Gain on sale of property and equipment	(47)	(29)
Amortization of deferred interest	70	74
Deferred compensation	99	
Stock-based compensation windfall tax benefit	(1,072)	
Amortization of bank financing costs	63	45
Changes in operating assets and liabilities, net of effects of acquisitions		
Trade accounts receivable	(1,362)	(7,093)
Accounts receivable related party	(1,651)	(2,443)
Prepaid expenses and other current assets	891	3
Accounts payable and accrued expenses	(3,247)	1,875
Accounts payable related party	(1,844)	(99)
Deferred revenue and other current liabilities	349	1,267
Other long-term liabilities	341	96
Deferred rent	152	
Other assets	11	(566)
 Net cash provided by operating activities	 15,477	 7,647
 <b>Cash flows from investing activities</b>		
Capital expenditures	(1,691)	(2,162)
Funds released from escrow and other restricted cash	47	279
Purchase of short term investments	(76,250)	
Sale of short term investments	15,750	
Capitalized software and web site development costs	(1,891)	(2,737)
Proceeds from sale of property and equipment	50	30
Cash acquired in purchase of a subsidiary		(225)
Payment for net assets acquired, net of acquired cash	(31,203)	(62,659)
 Net cash used in investing activities	 (95,188)	 (67,474)



**Cash flows from financing activities**

Principal payments on capital lease obligations	(250)	(219)
Proceeds from the exercise of employee stock options	901	1,398
Proceeds from employee stock purchase plan	370	
Net proceeds from bank indebtedness		47,329
Repayments of bank indebtedness		(5,000)
Principal payments on notes payable	(210)	
Stock-based compensation windfall tax benefit	1,072	
Deferred financing costs initial public offering	12	

Net cash provided by financing activities	1,895	43,508
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Net decrease in cash and cash equivalents	(77,816)	(16,319)
Effect of exchange rate changes on cash and cash equivalents	71	(6)
Cash beginning of period	103,264	21,753

Cash end of period	\$ 25,519	\$ 5,428
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**Supplemental disclosure**

Income taxes	\$ 7,629	\$ 1,028
Interest	38	75
Non-cash investing and financing activities:		
Acquisition of capitalized software through note payable	2,608	
Accrued capitalized hardware and software	1,132	
Global Fax purchase price adjustment	400	
Goodwill adjustment	382	
Deferred compensation reversal to equity	209	

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

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**DEALERTRACK HOLDINGS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)**

**1. Business Description**

We are a leading provider of on-demand software, network and data solutions for the automotive retail industry in the United States. Utilizing the Internet, DealerTrack has built a network connecting automotive dealers with banks, finance companies, credit unions and other financing sources, and other service and information providers, such as aftermarket providers and the major credit reporting agencies. We have established a network of active relationships, which as of June 30, 2006, consisted of over 22,000 automotive dealers, including over 85% of all franchised dealers; over 240 financing sources, including the 20 largest independent financing sources in the United States; and a number of other service and information providers to the automotive retail industry. Our credit application processing product enables dealers to automate and accelerate the indirect automotive financing process by increasing the speed of communications between these dealers and their financing sources. We have leveraged our leading market position in credit application processing to address other inefficiencies in the automotive retail industry value chain. We believe our proven network offers a competitive advantage for distribution of our software and data solutions. Our integrated subscription-based software products and services enable our automotive dealer customers to receive valuable consumer leads, compare various financing and leasing options and programs, sell insurance and other aftermarket products, analyze inventory and document compliance with certain laws and execute financing contracts electronically. We have created efficiencies for financing source customers by providing a comprehensive digital and electronic contracting solution. In addition, we offer data and other products and services to various industry participants, including lease residual value and automobile configuration data.

**2. Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited consolidated financial statements as of June 30, 2006 and for the three and six months ended June 30, 2006 and 2005 have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting only of normal and recurring adjustments, considered necessary for a fair statement have been included in the accompanying unaudited consolidated financial statements. All intercompany transactions and balances have been eliminated in consolidation. Operating results for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2006. The December 31, 2005 balance sheet information has been derived from the audited 2005 financial statements. For further information, please refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission on March 30, 2006.

Included in our provision for income taxes for the three and six months ended June 30, 2006 is approximately \$355,000 and \$206,000, respectively, of additional tax expense that relates to prior periods. This additional tax expense relates to an adjustment in our calculation of income taxes associated with our Canadian subsidiary, dealerAccess Canada, Inc.

***Short-term Investments***

We account for investment in marketable securities in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities.

Short-term investments as of June 30, 2006 consist of auction rate securities that are invested in tax-exempt and tax-advantaged securities. We classify investment securities as available for sale, and as a result, report the investments at fair value. There were no unrealized gains (losses) as of June 30, 2006.

Auction rate securities have long-term underlying maturities, but have interest rates that are reset every one year or less. The securities can be purchased or sold at any time, which creates a highly liquid market for these securities. Our intent is not to hold these securities to maturity, but rather to use the interest rate reset feature to provide liquidity as necessary. Our investment in these securities generally provides higher yields than money market and other cash

equivalent investments.

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For the three and six months ended June 30, 2006, basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the quarter. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding (including unvested restricted common stock), assuming dilution. The calculation assumes that all stock options that are in the money are exercised at the beginning of the period and the proceeds used by us to purchase shares at the average market price for the period.

For the three and six months ended June 30, 2005, we computed net income per share in accordance with SFAS No. 128, Earnings per Share and EITF No. 03-06, Participating Securities and the Two-Class Method under FASB Statement No. 128. Under the provisions of SFAS No. 128, basic earnings per share is computed by dividing the net income applicable to common stockholders by the weighted average number of shares of our common stock outstanding for the period. Diluted earnings per share is calculated based on the weighted average number of shares of common stock plus the diluted effect of potential common shares.

The following table sets forth the computation of basic and diluted net income per share applicable to common stockholders (in thousands, except share and per share amounts):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Numerator:</b>				
Net income	\$ 4,655	\$ 1,068	\$ 8,091	\$ 3,137
Amount allocated to participating preferred stockholders under two-class method(1)		(1,041)		(3,067)
Net income applicable to common stockholders	\$ 4,655	\$ 27	\$ 8,091	\$ 70
<b>Denominator:</b>				
Weighted average common stock outstanding (basic)	35,402,769	633,975	35,335,493	567,302
Common equivalent shares from options to purchase common stock and restricted common stock	1,530,597	627,636	1,542,849	485,461
Weighted average common stock outstanding (diluted)	36,933,366	1,261,611	36,878,342	1,052,763
Basic net income per share applicable to common stockholders	\$ 0.13	\$ 0.04	\$ 0.23	\$ 0.12
Diluted net income per share applicable to common stockholders	\$ 0.13	\$ 0.02	\$ 0.22	\$ 0.07

(1)

Not applicable  
for the three and  
six months  
ended June 30,  
2006, as all  
outstanding  
participating  
preferred stock  
was converted  
into common  
stock upon our  
initial public  
offering in  
December 2005.

The following is a summary of the securities outstanding during the respective periods that have been excluded from the diluted net income per share calculation because the effect would have been antidilutive:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Stock options	738,450	990,625	738,450	990,625
Restricted common stock	28,000		154,000	
Preferred stock		24,765,127		24,765,127
Total	766,450	25,755,752	892,450	25,755,752

#### ***Stock-Based Compensation Expense***

We maintain several share-based incentive plans. We grant stock options to purchase common stock and grant restricted common stock. In January 2006, we began offering an employee stock purchase plan that allows employees to purchase our common stock at a discount each quarter through payroll deductions. See Note 9 for further disclosure on our share-based incentive plans.

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Prior to the effective date of SFAS No. 123(R), Shared-Based Payment, we applied APB No. 25 Accounting for Stock Issued to Employees and related interpretations for our stock option and restricted common stock grants. APB No. 25 provides that the compensation expense is measured based on the intrinsic value of the stock award at the date of grant.

Effective January 1, 2006, we adopted SFAS 123(R), which requires us to measure and recognize the cost of employee services received in exchange for an award of equity instruments. Under the provisions of SFAS 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award, and recognized as an expense over the requisite service period.

As permitted by SFAS 123(R), we elected the modified prospective transition method. Under this method, prior periods are not revised. We use the Black-Scholes Option Pricing Model, which requires extensive use of accounting judgment and financial estimates, including estimates of the expected term employees will retain their vested stock options before exercising them, the estimated volatility of our stock price over the expected term, and the number of options that will be forfeited prior to the completion of their vesting requirements. Application of alternative assumptions could produce significantly different estimates of the fair value of stock-based compensation and consequently, the related amounts recognized in our consolidated statements of operations. The provisions of SFAS No. 123(R) apply to new awards and awards outstanding, but not yet vested, on the effective date. In March 2005, the SEC issued SAB No. 107 relating to SFAS No. 123(R). We have applied the provisions of SAB No. 107 in our adoption.

On December 13, 2005, we commenced an initial public offering (IPO) of our common stock. Prior to our IPO, we measured awards using the minimum-value method for SFAS 123 pro forma disclosure purposes. SFAS 123(R) requires that a company that measured awards using the minimum value method for SFAS 123 prior to its IPO filing, but adopts SFAS 123(R) as a public company, should not record any compensation amounts measured using the minimum value method in its financial statements. As a result, we will continue to account for pre-IPO awards under APB No. 25 unless they are modified after the adoption of SFAS 123(R). For post-IPO awards, compensation expense recognized after the adoption of SFAS 123(R) will be based on fair value of the awards on the date of grant.

In November 2005, the FASB issued FASB Staff Position ( FSP ) SFAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-based Payment Awards*, that provides an elective alternative transition method of calculating the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R) to the method otherwise required by paragraph 81 of SFAS No. 123(R). We may take up to one year from the effective date of the FSP to evaluate our available alternatives and make our one-time election. We are currently evaluating the alternative methods.

Stock-based compensation expense recognized under SFAS No. 123(R) for the three and six months ended June 30, 2006 was \$0.8 million and \$1.4 million, respectively, which consisted of stock-based compensation expense related to employee stock options, employee stock purchases and restricted common stock awards. For the three and six months ended June 30, 2006, we recorded stock-based compensation expense of \$0.6 million and \$1.2 million, respectively, in accordance with APB No. 25, using the intrinsic value approach to measure compensation expense.

The following is the effect of adopting SFAS No. 123(R) as of January 1, 2006 (in thousands, except per share amounts):

	<b>Three Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2006</b>
Stock options, restricted common stock and employee stock purchase plan compensation expense recognized:		
Cost of revenue	\$ 181	\$ 343
Product development	62	113
Selling, general and administrative	537	937
Total stock-based compensation expense	780	1,393

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Related deferred income tax benefit		(304)		(543)
Decrease in net income	\$	476	\$	850
Decrease in basic earnings per share	\$	0.01	\$	0.02
Decrease in diluted earnings per share	\$	0.01	\$	0.02

Upon the adoption of SFAS No. 123(R), we did not have a cumulative effect of accounting change.

The fair market value of each option grant for all years presented has been estimated on the date of grant using the Black-Scholes Option Pricing Model with the following assumptions:

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	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005 (Pro forma)</b>	<b>2006</b>	<b>2005 (Pro forma)</b>
Expected life (in years)(1)	6.25	5.00	6.25	5.00
Risk-free interest rate	5.04%	3.71%	4.38%	3.73%
Expected volatility(2)	47.00%	0%	47.00%	0%
Expected dividend yield	0%	0%	0%	0%

(1) For the three and six months ended June 30, 2006, the expected lives of options were determined based on the simplified method under the provisions of SAB 107. Due to limited history, we believe we do not have appropriate historical experience to estimate future exercise patterns. As more information becomes available, we may revise this estimate on a prospective basis.

(2) We started trading in connection with our initial public offering on December 13, 2005, and have



had a brief trading history to determine expected volatility based on historical performance of our traded common stock.

As a private company (for awards issued prior to December 13, 2005), we used 0% volatility. Due to the short public trading of our common stock, we estimated the expected volatility based on the historical volatility of similar entities whose common shares are publicly traded.

Using the Black-Scholes Option Pricing Model, the estimated weighted average fair value of an option to purchase one share of common stock granted during the three and six months ended June 30, 2006, was \$12.07 and \$11.05, respectively. The estimated weighted average fair value of an option to purchase one share of common stock granted during the three and six months ended June 30, 2005, was \$6.01 and \$3.37, respectively.

The following table illustrates the effect on net income and net income per share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based awards to the three and six months ended June 30, 2005 (in thousands, except per share amounts):

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Net income	\$ 1,068	\$ 3,137
Add: Stock-based compensation expense included in reported net income, net of taxes	226	379
Deduct: Stock-based compensation expense under the fair value method, net of taxes	(365)	(599)