DealerTrack Holdings, Inc.
Form 10-Q
May 09, 2008

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

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

For the quarterly period ended March 31, 2008

OR

o **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	**52-2336218**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1111 Marcus Ave., Suite M04 **Lake Success, NY**	**11042**
(Address of principal executive offices)	(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 þ No o

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

þ Large accelerated filer	o Accelerated filer
o Non-accelerated filer (Do not check if a smaller reporting company)	o Smaller reporting company

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

As of April 30, 2008, 42,628,125 shares of the registrant s common stock were outstanding.

DEALERTRACK HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008
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PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

DEALERTRACK HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

	March 31, 2008	December 31, 2007
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 206,747	$ 50,564
Short-term investments		169,580
Accounts receivable, net of allowances of $3,550 and $2,615 at March 31, 2008 and December 31, 2007, respectively	27,105	26,957
Prepaid expenses and other current assets	7,351	7,305
Deferred tax assets	3,329	3,827
Total current assets	244,532	258,233
Non-current investments	18,214	
Property and equipment, net	12,515	12,792
Software and web site developments costs, net	10,972	10,771
Intangible assets, net	62,321	69,528
Goodwill	116,733	117,702
Restricted cash	540	540
Deferred taxes and other long-term assets	13,979	13,360
Total assets	$ 479,806	$ 482,926
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 3,414	$ 4,762
Accrued compensation and benefits	5,309	12,527
Accrued other	12,192	11,387
Deferred revenue	4,876	4,016
Due to acquirees	1,717	2,251
Capital leases payable	375	480
Total current liabilities	27,883	35,423
Capital leases payable long-term	722	1,076
Due to acquirees long-term	1,313	1,280
Deferred tax liabilities long-term	2,429	2,800

Deferred revenue and other long-term liabilities		4,392		3,985
Total liabilities		36,739		44,564
Commitments and contingencies (Note 16)				
Stockholders equity				
Preferred stock, $0.01 par value; 10,000,000 shares authorized and no shares issued and outstanding at March 31, 2008 and December 31, 2007				
Common stock, $0.01 par value; 175,000,000 shares authorized; 42,634,269 shares issued and 42,628,229 shares outstanding at March 31, 2008 and 175,000,000 shares authorized; 42,556,925 shares issued and 42,552,723 shares outstanding at December 31, 2007		426		426
Treasury stock, at cost, 6,040 and 4,202 shares at March 31, 2008 and December 31, 2007, respectively		(191)		(139)
Additional paid-in capital		417,750		413,428
Deferred stock-based compensation (APB 25)		(1,634)		(2,056)
Accumulated other comprehensive income		5,856		8,181
Retained earnings		20,860		18,522
Total stockholders equity		443,067		438,362
Total liabilities and stockholders equity	$	479,806	$	482,926

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

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

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
	(In thousands, except share and per share amounts)	
Revenue		
Net revenue	$ 64,308	$ 51,725
Operating costs and expenses		
Cost of revenue (1)	28,612	21,300
Product development (1)	3,142	2,380
Selling, general and administrative (1)	29,732	21,248
Total operating costs and expenses	61,486	44,928
Income from operations	2,822	6,797
Interest income	1,563	1,531
Interest expense	(92)	(62)
Income before provision for income taxes	4,293	8,266
Provision for income taxes	(1,955)	(3,441)
Net income	$ 2,338	$ 4,825
Basic net income per share	$ 0.06	$ 0.12
Diluted net income per share	$ 0.05	$ 0.12
Weighted average shares outstanding	41,636,035	38,625,215
Weighted average shares outstanding assuming dilution	42,882,662	40,231,194

(1) Stock-based compensation expense recorded for the three months ended March 31, 2008 and 2007 was classified as follows:

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007

	(In thousands)			
Cost of revenue	$	614	$	414
Product development		177		136
Selling, general and administrative		2,670		1,579

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)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
	(In thousands)	
Cash flows from operating activities		
Net income	$ 2,338	$ 4,825
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	10,522	7,846
Deferred tax benefit	(526)	(2,075)
Amortization of deferred stock-based compensation	3,461	2,129
Provision for doubtful accounts and sales credits	1,539	1,008
Loss on sale of property and equipment		15
Amortization of deferred interest	50	42
Deferred compensation	62	70
Amortization of bank financing costs	30	30
Stock-based compensation windfall tax benefit	(96)	(1,141)
Changes in operating assets and liabilities, net of effects of acquisitions		
Trade accounts receivable	(1,803)	(3,146)
Prepaid expenses and other current assets	(56)	612
Accounts payable and accrued expenses	(7,818)	(5,760)
Deferred revenue and other current liabilities	873	921
Other long-term liabilities	175	21
Deferred rent	234	77
Other long-term assets	(2)	(16)
Net cash provided by operating activities	8,983	5,458
Cash flows from investing activities		
Capital expenditures	(1,044)	(811)
Purchase of short-term investments	(44,000)	(58,050)
Sale of short-term investments	195,080	75,805
Capitalized software and web site development costs	(1,537)	(957)
Proceeds from sale of property and equipment	2	
Payment for net assets acquired, net of acquired cash	(1,599)	(37,832)
Net cash provided by (used in) investing activities	146,902	(21,845)
Cash flows from financing activities		
Principal payments on capital lease obligations	(458)	(105)
Proceeds from the exercise of employee stock options	444	833
Proceeds from employee stock purchase plan	681	430

Purchase of treasury stock		(53)		(41)
Stock-based compensation windfall tax benefit		96		1,141
Other				(1)
Net cash provided by financing activities		710		2,257
Net increase (decrease) in cash and cash equivalents		156,595		(14,130)
Effect of exchange rate changes on cash and cash equivalents		(412)		85
Cash, beginning of period		50,564		47,080
Cash, end of period	$	206,747	$	33,035
Supplemental disclosure				
Cash paid for:				
Income taxes	$	385	$	3,356
Interest		42		21
Non-cash investing and financing activities:				
Accrued capitalized hardware, software and fixed assets	$	333	$	1,679
Deferred compensation reversal to equity		63		136

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

DealerTrack Holdings, Inc. is a leading provider of on-demand software, and data solutions for the automotive and related specialty retail industries in the United States. Utilizing the Internet, we have 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 in the United States, which as of March 31, 2008, consisted of over 22,000 dealers, including approximately 90% of all franchised dealers; over 500 financing sources 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 provides a competitive advantage for distribution of our software and data solutions. Our integrated subscription-based software products and services enable our dealer customers to manage their dealership and operations, receive valuable consumer leads, compare various financing and leasing options and programs, sell insurance and other aftermarket products, analyze inventory, document compliance with certain laws and execute financing contracts electronically. We have also 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. Basis of Presentation

The accompanying unaudited consolidated financial statements as of March 31, 2008 and for the three months ended March 31, 2008 and 2007 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 for a complete set of financial statements in accordance with accounting principles generally accepted in the United States of America. 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 months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2008. The December 31, 2007 balance sheet information has been derived from the audited 2007 consolidated financial statements, but does not include all disclosures required for a complete set of financial statements in accordance with accounting principles generally accepted in the United States of America. 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, 2007, filed with the Securities and Exchange Commission (SEC) on February 28, 2008.

3. Recent Accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We have elected not to apply SFAS No. 159 to any of our existing assets or liabilities.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. For further information about the adoption of the required provisions of SFAS No. 157 see Note 4.

In February 2008, the FASB issued FSP SFAS No. 157-2 *Effective Date of FASB Statement 157* delaying the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We are currently evaluating the impact that this statement will have on our consolidated financial statements.

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4. Fair Value Measurements

Effective January 1, 2008, we adopted SFAS No. 157, which defines the fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair values are as follows:

Level 1 Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2 Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3 Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

We have segregated all financial assets that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date in the table below.

Assets measured at fair value on a recurring basis include the following as of March 31, 2008 (in thousands):

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value at March 31, 2008
Cash equivalents (1)	$ 19,046	$	$	$ 19,046
Non-current investments (2)			18,214	18,214
Total	$ 19,046	$	$ 18,214	$ 37,260

(1) Cash equivalents consist primarily of money market funds with original maturity dates of three months or less, for which we determine fair value through quoted market

prices.

(2) Non-current investments consist of auction rate securities (ARS) that are invested in tax-exempt and tax-advantaged preferred stock trust securities. We classify investment securities as available for sale, and as a result, report the investments at fair value. Auction rate securities have long-term underlying maturities, but have interest rates that are reset every one year or less. 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 provide higher interest rates than money market and other cash equivalent investments. Due to the

recent lack of observable market quotes on our ARS portfolio due to failed auctions within the industry, we utilize valuation models that rely exclusively on Level 3 inputs including those that are based on expected cash flow streams, including assessments of counterparty credit quality, default risk underlying the security, discount rates and overall capital market liquidity. The valuation of our ARS investment portfolio is subject to uncertainties that are difficult to predict. If the issuers of these securities are unable to successfully complete future auctions or refinance their obligations and their credit ratings deteriorate, we may be required to adjust the carrying value of these securities and recognize an impairment charge for an other-than temporary decline in the fair value. We believe that we will be able to liquidate our investment without material loss and that these securities are not permanently impaired, however, due to the uncertainty of whether we will be able to sell these securities within the next year we have reclassified them to long-term at March 31, 2008. Based on our available cash and other investments, we do not currently anticipate that the lack of liquidity caused by failed auctions will have a material adverse effect on our operating cash flows or will affect our ability to operate our business as usual.

The change in the carrying amount of investments for the three months ended March 31, 2008 is as follows (in thousands):

Balance as of January 1, 2008	$	169,580

Net sales of auction rate securities		(151,080)
Unrealized losses included in accumulated other comprehensive income		(286)
Balance as of March 31, 2008	$	18,214

5. Net Income per Share

For the three months ended March 31, 2008 and 2007, we computed net income per share in accordance SFAS No. 128, *Earnings per Share* (SFAS No. 128). Under the provisions of SFAS No. 128, basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding, assuming dilution, during the period. The diluted earnings per share calculation assumes that (i) all stock options, which are in the money are exercised at the beginning of the period and the proceeds are used by us to purchase shares at the average market price for the period and (ii) if applicable, unvested awards that are considered to be contingently issuable shares because they contain either a performance or market condition will be included in diluted earnings per share in accordance with SFAS No. 128 if dilutive and if their conditions (a) have been satisfied at the reporting date or (b) would have been satisfied if the reporting date was the end of the contingency period.

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

	Three Months Ended March 31,	
	2008	**2007**
Numerator:		
Net income	$ 2,338	$ 4,825
Denominator:		
Weighted average common stock outstanding (basic)	41,636,035	38,625,215
Common equivalent shares from options to purchase common stock, restricted common stock and contingent restricted common stock (1)	1,246,627	1,605,979
Weighted average common stock outstanding (diluted)	42,882,662	40,231,194
Basic net income per share	$ 0.06	$ 0.12
Diluted net income per share	$ 0.05	$ 0.12

(1) In accordance with SFAS No. 128, for the three months ended March 31, 2008 and 2007, we have excluded 393,333 and 386,667 contingently issuable shares, respectively,

from diluted weighted average common stock outstanding as their contingent considerations (a) have not been satisfied at the reporting date nor (b) would have been satisfied if the reporting date was the end of the contingency period. (Refer to Note 15 for further information).

The following is a summary of the weighted 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:

	Three Months Ended March 31, 2008	2007
Stock options	1,858,968	380,131
Restricted common stock	73,084	77,310
Total	1,932,052	457,441

6. Comprehensive Income

The components of comprehensive income were as follows (in thousands):

	Three Months Ended March 31, 2008	2007
Net income	$ 2,338	$ 4,825
Foreign currency translation adjustments	(2,039)	731
Unrealized loss on available-for-sale securities	(286)	
Total	$ 13	$ 5,556

For the three months ended March 31, 2008 and 2007, the foreign currency translation adjustment primarily represents the effect of translating the intangibles and goodwill related to the Curomax acquisition.

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7. Stock-Based Compensation Expense

We have three types of stock-based compensation programs: stock options, restricted common stock and an employee stock purchase plan (ESPP). For further information see Notes 2 and 12 included in our Annual Report on Form 10-K for the year ended December 31, 2007.

The following summarizes stock-based compensation expense recognized for the three months ended March 31, 2008 and 2007 (in thousands):

	Three Months Ended March 31,	
	2008	2007
Stock options	$ 1,930	$ 1,225
Restricted common stock	1,411	828
ESPP	120	76
Total stock-based compensation expense	$ 3,461	$ 2,129

Stock-based compensation expense recognized for the three months ended March 31, 2008 was $3.5 million, of which $3.1 million was in accordance with FAS 123(R) and $0.4 million in accordance with APB 25. Stock-based compensation expense recognized for the three months ended March 31, 2007 was $2.1 million, of which $1.6 million was in accordance with FAS 123(R) and $0.5 million in accordance with APB 25.

Refer to Note 15 for further information regarding our long-term incentive equity awards.

8. Stock Repurchase Program

On March 18, 2008, the board of directors authorized a stock repurchase program under which we may spend up to $75 million to repurchase shares of our common stock. Stock repurchases under this program may be made on the open market, through 10b5-1 programs, or in privately negotiated transactions in accordance with all applicable laws, rules and regulations. The transactions may be made from time to time without prior notice and in such amounts as our management deems appropriate and will be funded from cash on hand. The number of shares to be repurchased and the timing of repurchases will be based on several factors, including the price of our common stock, legal or regulatory requirements, general business and market conditions, and other investment opportunities. The stock repurchase program will expire on March 31, 2009, but may be limited or terminated at any time by our Board of Directors without prior notice. There were no repurchases under this program for the three months ended March 31, 2008.

9. Related Party Transactions

We entered into several agreements with a stockholder and its affiliates that is a service provider for automotive dealers. These automotive dealers may utilize our network to access customer credit reports and customer leads provided by or through this related party. We earn revenue from this related party for each credit report or customer lead that is accessed using our web-based service. The total amount of net revenue from this related party for the three months ended March 31, 2008 and 2007 was $0.7 million and $0.6 million, respectively. The total amount of accounts receivable from this related party as of March 31, 2008 and December 31, 2007 was $0.2 million.

10. Property and Equipment

Property and equipment are recorded at cost and consist of the following (dollars in thousands):

	Estimated Useful Life (Years)	March 31, 2008	December 31, 2007
Computer equipment	3	$ 16,987	$ 16,719

Office equipment	5	2,418	2,189
Furniture and fixtures	5	3,007	2,840
Leasehold improvements	5-11	1,085	992
Total property and equipment, gross		23,497	22,740
Less: Accumulated depreciation and amortization		(10,982)	(9,948)
Total property and equipment, net		$ 12,515	$ 12,792

Depreciation and amortization expense related to property and equipment for the three months ended March 31, 2008 and 2007 was $1.4 million and $0.8 million, respectively, and is calculated on a straight line basis over the estimated useful life of the asset.

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11. Intangible Assets

Intangible assets principally are comprised of customer contracts, database, trade names, licenses, patents, technology, non-competition agreements, and contractual agreements. The amortization expense relating to intangible assets is recorded as a cost of revenue. The gross book value, accumulated amortization and amortization periods of the intangible assets were as follows (dollars in thousands):

