DealerTrack Holdings, Inc.
Form 10-Q
August 07, 2009

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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 June 30, 2009

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 has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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):

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

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 July 31, 2009, 40,301,971 shares of the registrant s common stock were outstanding.

DEALERTRACK HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED June 30, 2009

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

DEALERTRACK HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2009	December 31, 2008
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 178,254	$ 155,456
Short-term investments	1,108	43,350
Accounts receivable, net of allowances of $2,968 and $1,848 at June 30, 2009 and December 31, 2008, respectively	19,729	18,462
Prepaid expenses and other current assets	13,932	9,624
Deferred tax assets	2,270	2,195
Restricted cash	28	142
Total current assets	215,321	229,229
Long-term investments	3,964	4,392
Property and equipment, net	14,350	13,448
Software and web site developments costs, net	16,560	12,705
Intangible assets, net	50,899	44,405
Goodwill	131,084	114,886
Restricted cash	250	250
Deferred taxes and other long-term assets	21,326	17,900
Total assets	$ 453,754	$ 437,215
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 3,934	$ 4,488
Accrued compensation and benefits	10,300	7,850
Accrued other	12,366	11,385
Deferred revenues	5,213	5,609
Due to acquirees	600	1,740
Capital leases payable	359	360
Total current liabilities	32,772	31,432
Capital leases payable long-term	272	454

Due to acquirees long-term		682
Deferred tax liabilities long-term	5,016	2,477
Deferred revenue and other long-term liabilities	5,975	5,950
Total liabilities	44,035	40,995
Commitments and contingencies (Note 17)		
Stockholders equity		
Preferred stock, $0.01 par value: 10,000,000 shares authorized and no shares issued and outstanding at June 30, 2009 and December 31, 2008		
Common stock, $0.01 par value: 175,000,000 shares authorized; 43,333,994 shares issued and 40,296,894 shares outstanding at June 30, 2009; and 175,000,000 shares authorized; 42,841,737 shares issued and 39,833,616 shares outstanding at December 31, 2008	433	428
Treasury stock, at cost, 3,037,100 shares and 3,008,121 shares at June 30, 2009 and December 31, 2008, respectively	(50,395)	(50,061)
Additional paid-in capital	442,521	428,771
Deferred stock-based compensation (APB 25)	(41)	(446)
Accumulated other comprehensive income	381	(2,730)
Retained earnings	16,820	20,258
Total stockholders equity	409,719	396,220
Total liabilities and stockholders equity	$ 453,754	$ 437,215

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 June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands, except share and per share amounts)		(In thousands, except share and per share amounts)	
Revenue				
Net revenue	$ 57,870	$ 63,181	$ 113,570	$ 127,489
Operating costs and expenses				
Cost of revenue (1)	28,852	27,879	57,973	56,491
Product development (1)	3,514	3,084	7,646	6,226
Selling, general and administrative (1)	25,280	28,010	57,598	57,742
Total operating costs and expenses	57,646	58,973	123,217	120,459
Income (loss) from operations	224	4,208	(9,647)	7,030
Interest income	341	1,145	743	2,708
Other income	2		52	
Interest expense	(76)	(74)	(126)	(166)
Realized gain on securities	930		1,393	
Income (loss) before benefit (provision) for income taxes	1,421	5,279	(7,585)	9,572
Benefit (provision) for income taxes, net	766	(2,213)	4,147	(4,168)
Net income (loss)	$ 2,187	$ 3,066	$ (3,438)	$ 5,404
Basic net income (loss) per share applicable to common stockholders (2)	$ 0.05	$ 0.07	$ (0.09)	$ 0.13
Diluted net income (loss) per share applicable to common stockholders (2)	$ 0.05	$ 0.07	$ (0.09)	$ 0.12
Weighted average shares outstanding (2)	39,499,313	41,505,451	39,298,637	41,569,417
Weighted average shares outstanding assuming dilution (2)	40,458,174	42,609,342	39,298,637	42,704,862

(1) Stock-based compensation expense

recorded for the three and six months ended June 30, 2009 and 2008 was classified as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009 (3)	2008
Cost of revenue	$ 634	$ 599	$ 1,247	$ 1,213
Product development	199	181	408	358
Selling, general and administrative	2,573	2,754	9,157	5,424

(2) Basic and diluted income per share amounts for the three and six months ended June 30, 2008 have been retroactively adjusted to conform with the provisions of FSP No. EITF 03-6-1. For further information about the adoption of the provisions of FSP No. EITF 03-6-1 refer to Note 5.

(3) Included in stock-based compensation expense for the six months ended June 30, 2009 was $3.9 million of stock-based compensation expense related to the

realignment of our workforce and business on January 5, 2009. For further information about the realignment of our workforce and business see Note 18.

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)

	Six Months Ended June 30, 2009	2008
	(In thousands)	
Cash flows from operating activities		
Net (loss) income	$ (3,438)	$ 5,404
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Depreciation and amortization	17,888	20,208
Deferred tax benefit	(3,675)	(1,135)
Stock-based compensation expense	10,812	6,995
Provision for doubtful accounts and sales credits	4,749	3,572
(Gain) loss on sale of property and equipment	(167)	1
Amortization of bond premium	56	18
Amortization of deferred interest	70	103
Non cash deferred compensation	150	125
Amortization of bank financing costs		31
Stock-based compensation windfall tax benefit	(1,508)	(290)
Realized gain on securities	(1,393)	
Changes in operating assets and liabilities, net of effects of acquisitions		
Trade accounts receivable	(5,850)	(4,248)
Prepaid expenses and other current assets	(3,858)	(1,844)
Accounts payable and accrued expenses	4,761	(6,527)
Deferred revenue and other current liabilities	250	1,499
Other long-term liabilities	(55)	543
Deferred rent	79	360
Other long-term assets	(228)	(519)
Net cash provided by operating activities	18,643	24,296
Cash flows from investing activities		
Capital expenditures	(3,239)	(2,991)
Other restricted cash	114	
Purchase of investments		(144,084)
Sale of investments	44,569	264,912
Capitalized software and web site development costs	(6,327)	(4,410)
Proceeds from sale of property and equipment	78	2
Payment for acquisition of businesses and intangible assets, net of acquired cash	(34,621)	(2,358)
Net cash provided by investing activities	574	111,071
Cash flows from financing activities		

Principal payments on capital lease obligations		(184)		(554)
Proceeds from the exercise of employee stock options		1,641		797
Proceeds from employee stock purchase plan		525		1,094
Purchase of treasury stock		(334)		(19,131)
Principal payments on notes payable		(423)		
Stock-based compensation windfall tax benefit		1,508		290
Net cash provided by (used in) financing activities		2,733		(17,504)
Net increase in cash and cash equivalents		21,950		117,863
Effect of exchange rate changes on cash and cash equivalents		848		(389)
Cash, beginning of period		155,456		50,564
Cash, end of period	$	178,254	$	168,038
Supplemental disclosure				
Cash paid for:				
Income taxes	$	3,087	$	4,846
Interest		29		84
Non-cash investing and financing activities:				
Asset sale through note receivable		500		
Accrued capitalized hardware, software and fixed assets		1,413		505
Goodwill adjustment		(12)		
Deferred compensation reversal to equity		150		125

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 retail industry 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 June 30, 2009, consisted of approximately 18,000 dealers, over 750 financing sources and many other service and information providers to the automotive retail industry. We consider a financing source to be active in our network as of a date if it has accepted credit application data electronically from dealers in the DealerTrack network in that month, including financing sources visible to dealers through drop down menus. 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 dealership management system (DMS) and integrated subscription-based software solutions enable our dealer customers to manage their dealership and operations, 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 June 30, 2009 and for the three and six months ended June 30, 2009 and 2008 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 and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2009. The December 31, 2008 balance sheet information has been derived from the audited 2008 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, 2008, filed with the Securities and Exchange Commission (SEC) on February 24, 2009 and amended on April 30, 2009.

3. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (SFAS No. 168). With the issuance of SFAS No. 168, the FASB Accounting Standards Codification (Codification) becomes the single source of authoritative U.S. accounting and reporting standards applicable for all nongovernmental entities, with the exception of guidance issued by the Securities and Exchange Commission (SEC). The Codification does not change current U.S. GAAP, but changes the referencing of financial standards, and is intended to simplify user access to authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. The Codification is effective for interim and annual periods ending after September 15, 2009, and is effective for our third quarter of 2009. At that time, all references made to U.S. GAAP will use the new Codification numbering system prescribed by the FASB. We are currently evaluating the impact that this statement will have on our consolidated financial statements. However, as SFAS No. 168 is not intended to change or alter existing U.S. GAAP, it is not expected to have any impact on our consolidated financial position or results of operations.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS No. 167). SFAS No. 167 modifies how a company determines when it is required to consolidate an entity and is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. SFAS No. 167 requires an ongoing reassessment of whether a company is the primary beneficiary of a variable interest entity. SFAS no. 167 also requires additional disclosures about a company s involvement in variable interest entities and any significant changes in risk exposure due to that involvement. SFAS No. 167 is effective for fiscal years beginning after November 15, 2009. We are currently evaluating the impact that this statement will have on our consolidated financial statements.

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In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS No. 165). SFAS No. 165 establishes principles and standards related to the accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued. The provisions of this statement are effective for interim or annual periods ending after June 15, 2009. The adoption of this statement did not have a material impact on our consolidated financial statements.

4. Fair Value Measurements

Fair value is defined 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. Inputs used to measure fair value are prioritized into a three-level fair value hierarchy. 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 June 30, 2009 (in thousands):

	Quoted Prices in Active Markets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**June 30, 2009**
Cash equivalents (1)	$ 132,980	$	$	$ 132,980
Short-term investments (2)	1,108			1,108
Long-term investments (3)			3,964	3,964
Total	$ 134,088	$	$ 3,964	$ 138,052

(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) As of December 31, 2008, we had $2.3 million (net of impairment charge) of Level 2 auction rate securities (ARS) invested in tax-advantaged preferred stock trusts in which the underlying equities are preferred stock. These ARS were associated with failed auctions, for which the trust dissolved and distributed the underlying preferred security during the first quarter of 2009. The result of this distribution is a realizable event in which we recognized a loss in the statement of operations of $0.3 million on the decreased fair value from December 31, 2008 through the dissolution of the trust. Subsequent to the trust dissolution the

fair value of the preferred securities are now based upon quoted market prices in active markets and were reclassed from a Level 2 asset to a Level 1 asset. For the three months ended June 30, 2009 we sold one preferred security for approximately $2.1 million and recorded a gain of $0.9 million in the statement of operations. As of June 30, 2009, the remaining preferred securities in our portfolio increased during the second quarter and a $0.3 million unrealized gain was recorded in other comprehensive income.

(3) Level 3 long-term investments includes $1.6 million in auction rate securities (ARS) invested in tax-exempt state government obligations that was valued at

par. Our intent is not to hold the ARS invested in tax-exempt state government obligations to maturity, but rather to use the interest reset feature to provide liquidity, if applicable. We have classified this as long-term due to the maturity date of the security being in 2011, coupled with ongoing failed auctions in the marketplace.

Level 3 long-term investments also includes $2.4 million of tax-advantaged preferred stock of a financial institution. It is uncertain whether we will be able to liquidate these securities within the next twelve months, as such we have classified them as long-term on our consolidated balance sheets. Due to the lack of observable market quotes we utilized 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.

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During the three months ended March 31, 2009 our investment in ARS invested in certain tax-advantaged preferred stock trusts as of December 31, 2008 dissolved and the trustee distributed the underlying preferred stock instruments. As a result of these conversions we measured the fair value of the Level 3 long-term tax-advantaged preferred stock on the distribution date and determined that the value increased from December 31, 2008. This resulted in a realized gain being recorded in the statement of operations of $0.7 million during the first quarter of 2009. As of June 30, 2009, the value of these preferred stock instruments had increased and as a result we recorded an unrealized gain of $0.3 million for the three months ended June 30, 2009 in other comprehensive income.

The change in the carrying amount of Level 3 investments for the six months ended June 30, 2009 is as follows (in thousands):

Balance as of January 1, 2009	$	1,550
Reclassification from Level 2 investments to Level 3 investments		1,360
Realized gain on securities included in the statement of operations		716
Unrealized gain on securities recorded in other comprehensive income		338
Balance as of June 30, 2009	$	3,964

5. Net Income (Loss) per Share

Effective January 1, 2009, we adopted FSP No. EITF 03-6-1. All prior-periods earnings per share data presented have been adjusted retroactively to conform with the provision of the FSP. The FSP addresses whether instruments granted in stock-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method. Our nonvested restricted common stock, which includes our long-term incentive equity awards, are considered participating securities since the share-based awards contain a non-forfeitable right to dividends irrespective of whether the awards ultimately vest and, therefore, have been included in the denominator of both the basic and diluted earnings per share calculations. FSP No. EITF 03-6-1 did not have a significant impact on our historical earnings per share calculations. Basic earnings per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding, assuming dilution, during the period.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008 (2)**	**2009**	**2008 (2)**
Numerator:				
Net income (loss)	$ 2,187	$ 3,066	$ (3,438)	$ 5,404
Net income allocated to participating securities under two-class method	(33)	(64)		(112)
Net income (loss) applicable to common stockholders	$ 2,154	$ 3,002	$ (3,438)	$ 5,292
Denominator:				
Weighted average common stock outstanding (basic)	39,499,313	41,505,451	39,298,637	41,569,417
Common equivalent shares from options to purchase common stock and restricted common stock units (1)	958,861	1,103,891		1,135,445

Weighted average common stock outstanding (diluted)	40,458,174	42,609,342	39,298,637	42,704,862
Basic net income (loss) per share	$ 0.05	$ 0.07	$ (0.09)	$ 0.13