DealerTrack Holdings, Inc.
Form 10-Q
August 09, 2007

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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, 2007

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, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2.)

Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer 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, 2007, 39,914,702 shares of the registrant s common stock were outstanding.

DEALERTRACK HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007
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PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

DEALERTRACK HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2007	December 31, 2006
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 33,599	$ 47,080
Short-term investments	58,000	124,115
Accounts receivable related party	434	398
Accounts receivable, net of allowances of $4,417 and $4,407 at June 30, 2007 and December 31, 2006, respectively	27,849	19,560
Prepaid expenses and other current assets	4,614	4,694
Deferred tax assets	3,846	2,483
Total current assets	128,342	198,330
Property and equipment, net	10,103	6,157
Software and web site developments costs, net	9,549	10,048
Intangible assets, net	77,324	37,918
Goodwill	115,344	52,499
Restricted cash	540	540
Deferred taxes and other long-term assets	18,728	16,021
Total assets	$ 359,930	$ 321,513
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 2,919	$ 1,818
Accrued compensation and benefits	8,389	10,111
Accrued other	17,325	11,978
Deferred revenue	4,213	3,166
Due to acquirees and other current liabilities	2,623	2,440
Total current liabilities	35,469	29,513
Due to acquirees long-term	2,336	2,982
Deferred taxes and other long-term liabilities	12,997	4,681

Total liabilities	50,802	37,176
Commitments and contingencies (Note 14)		
Stockholders equity		
Preferred stock, $0.01 par value; 10,000,000 shares authorized and no shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively		
Common stock, $0.01 par value; 175,000,000 shares authorized; 39,706,368 and 39,703,333 shares issued and outstanding at June 30, 2007, respectively; and 39,358,769 and 39,357,550 shares issued and outstanding at December 31, 2006, respectively	397	393
Treasury stock, at cost, 3,035 and 1,219 shares at June 30, 2007 and December 31, 2006, respectively	(85)	(31)
Additional paid-in capital	297,157	289,490
Deferred stock-based compensation (APB 25)	(3,170)	(4,322)
Accumulated other comprehensive income (foreign currency)	4,950	37
Retained earnings (accumulated deficit)	9,879	(1,230)
Total stockholders equity	309,128	284,337
Total liabilities and stockholders equity	$ 359,930	$ 321,513

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,	
	2007	2006	2007	2006
	(In thousands, except share and per share amounts)		(In thousands, except share and per share amounts)	
Revenue				
Net revenue(1)	$ 58,507	$ 43,414	$ 110,232	$ 81,349
Operating costs and expenses				
Cost of revenue(2)	24,158	17,289	45,458	32,408
Product development(2)	2,281	2,361	4,661	4,563
Selling, general and administrative(2)	22,313	16,474	43,561	32,443
Total operating costs and expenses	48,752	36,124	93,680	69,414
Income from operations	9,755	7,290	16,552	11,935
Interest income	1,220	785	2,751	1,748
Interest expense	(73)	(69)	(135)	(141)
Income before provision for income taxes	10,902	8,006	19,168	13,542
Provision for income taxes, net	(4,618)	(3,351)	(8,059)	(5,451)
Net income	$ 6,284	$ 4,655	$ 11,109	$ 8,091
Basic net income per share	$ 0.16	$ 0.13	$ 0.29	$ 0.23
Diluted net income per share	$ 0.15	$ 0.13	$ 0.27	$ 0.22
Weighted average shares outstanding	38,748,405	35,402,769	38,685,500	35,335,493
Weighted average shares outstanding assuming dilution	40,569,993	36,933,366	40,437,270	36,878,342

(1) Related party revenue for the three and six months ended June 30, 2007 and 2006 was as

follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Related party revenue	$ 622	$ 11,067	$ 1,242	$ 20,319

(2) Stock-based compensation expense recorded for the three and six months ended June 30, 2007 and 2006 was classified as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Cost of revenue	$ 476	$ 271	$ 890	$ 524
Product development	153	90	289	168
Selling, general and administrative	1,817	1,036	3,396	1,929

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, 2007	Six Months Ended June 30, 2006
	(In thousands)	
Cash flows from operating activities		
Net income	$ 11,109	$ 8,091
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	16,944	12,239
Deferred tax benefit	(3,129)	(2,548)
Amortization of stock-based compensation	4,575	2,621
Provision for doubtful accounts and sales credits	2,388	2,321
Loss (gain) on sale of property and equipment	17	(47)
Amortization of deferred interest	87	70
Deferred compensation	145	99
Amortization of bank financing costs	61	63
Stock-based compensation windfall tax benefit	(1,663)	(1,072)
Changes in operating assets and liabilities, net of effects of acquisitions		
Trade accounts receivable	(8,137)	(1,362)
Accounts receivable related party	(37)	(1,651)
Prepaid expenses and other current assets	1,086	891
Accounts payable and accrued expenses	(3,620)	(3,247)
Accounts payable related party		(1,844)
Deferred revenue and other current liabilities	1,048	349
Other long-term liabilities	(259)	341
Deferred rent	94	152
Other assets	(171)	11
Net cash provided by operating activities	20,538	15,477
Cash flows from investing activities		
Capital expenditures	(3,038)	(1,691)
Funds released from escrow and other restricted cash		47
Purchase of short-term investments	(227,850)	(76,250)
Sale of short-term investments	293,965	15,750
Capitalized software and web site development costs	(2,053)	(1,891)
Proceeds from sale of property and equipment	7	50
Payment for net assets acquired, net of acquired cash	(99,387)	(31,203)
Net cash used in investing activities	(38,356)	(95,188)
Cash flows from financing activities		

Principal payments on capital lease obligations	(5)	(250)
Proceeds from the exercise of employee stock options	1,552	901
Proceeds from employee stock purchase plan	823	370
Purchase of treasury stock	(54)	
Principal payments on notes payable	(211)	(210)
Stock-based compensation windfall tax benefit	1,663	1,072
Other	(1)	12
Net cash provided by financing activities	3,767	1,895
Net decrease in cash and cash equivalents	(14,051)	(77,816)
Effect of exchange rate changes on cash and cash equivalents	570	71
Cash beginning of period	47,080	103,264
Cash end of period	$ 33,599	$ 25,519
Supplemental disclosure		
Cash paid for:		
Income taxes	$ 11,181	$ 7,629
Interest	48	38
Non-cash investing and financing activities:		
Acquisition of capitalized software through note payable		2,608
Accrued capitalized hardware and software	609	1,132
Global Fax purchase price adjustment		400
Goodwill adjustment	72	382
Deferred compensation reversal to equity	211	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

DealerTrack Holdings, Inc. is a leading provider of on-demand software, network 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, 2007, consisted of over 22,000 dealers, including over 90% of all franchised dealers; over 375 financing sources; including the 20 largest independent 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 data 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 June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 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, 2007 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2007. The December 31, 2006 balance sheet information has been derived from the audited 2006 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, 2006, filed with the Securities and Exchange Commission on March 16, 2007 and amended on April 30, 2007.

Included in our provision for income taxes for the three and six months ended June 30, 2006 is approximately \$0.4 million and \$0.2 million, 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, DealerTrack Canada, Inc. (formerly known as DealerAccess Canada Inc.).

3. Net Income per Share

For the three and six months ended June 30, 2007 and 2006, we computed net income per share in accordance SFAS No. 128, *Earnings per Share.* 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 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.

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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 June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Numerator:				
Net income	$ 6,284	$ 4,655	$ 11,109	$ 8,091
Denominator:				
Weighted average common stock outstanding (basic)	38,748,405	35,402,769	38,685,500	35,335,493
Common equivalent shares from options to purchase common stock and restricted common stock (1)	1,821,588	1,530,597	1,751,770	1,542,849
Weighted average common stock outstanding (diluted)	40,569,993	36,933,366	40,437,270	36,878,342
Basic net income per share	$ 0.16	$ 0.13	$ 0.29	$ 0.23
Diluted net income per share	$ 0.15	$ 0.13	$ 0.27	$ 0.22

(1) In accordance with SFAS No. 128, for the three and six months ended June 30, 2007, we have excluded 290,000 contingently issuable shares from diluted weighted average common stock outstanding as their contingent conditions (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. These contingent restricted common stock awards were not in effect for the six months ended June 30, 2006 (Refer to Note 13 for further information).

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:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Stock options	488,966	738,450	431,245	738,450
Restricted common stock		28,000	101,300	154,000
Total	488,966	766,450	532,545	892,450

4. Comprehensive Income

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Net income	$ 6,284	$ 4,655	$ 11,109	$ 8,091
Foreign currency translation adjustments	4,182	110	4,913	100
Total	$ 10,466	$ 4,765	$ 16,022	$ 8,191

***5.* Stock-Based Compensation Expense**

We have three types of stock-based compensation programs: stock options, restricted 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, 2006.

The following summarizes stock-based compensation expense recognized for the three and six months ended June 30, 2007 and 2006 (in thousands):

	Three Months Ended June 30,	Six Months Ended June 30,

	2007	2006	2007	2006
Stock options	$ 1,473	$ 1,015	$ 2,698	$ 1,930
Restricted common stock	904	342	1,732	626
ESPP	69	40	145	65
Total	$ 2,446	$ 1,397	$ 4,575	$ 2,621

Stock-based compensation expense recognized for the three months ended June 30, 2007 was $2.4 million, of which $1.9 million was in accordance with FAS 123R and $0.5 million in accordance with APB 25. Stock-based compensation expense recognized for the three months ended June 30, 2006 was $1.4 million, of which $0.8 million was in accordance with FAS 123R and $0.6 million in accordance with APB 25.

Stock-based compensation expense recognized for the six months ended June 30, 2007 was $4.6 million, of which $3.5 million was in accordance with FAS 123R and $1.1 million in accordance with APB 25. Stock-based compensation expense recognized for the six months ended June 30, 2006 was $2.6 million, of which $1.4 million was in accordance with FAS 123R and $1.2 million in accordance with APB 25.

Refer to Note 13 for further information regarding our long-term incentive equity awards.

6. Business Combinations

Curomax Acquisition

On February 1, 2007, we completed the purchase of all of the outstanding shares of Curomax Corporation and its subsidiaries (Curomax) pursuant to a shares purchase agreement, made as of January 16, 2007, for a cash purchase price of approximately $39.0 million (including estimated direct acquisition and restructuring costs of approximately $1.8 million). Under the terms of the shares purchase agreement, we have future contingent payment obligations of approximately $2.1 million in cash to be paid out based upon the achievement of certain operational objectives over the subsequent twenty-four months. The additional purchase consideration, if any, will be recorded as additional goodwill on our consolidated balance sheet when the contingency is resolved. As of June 30, 2007, none of these contingencies were resolved.

Curomax offers an online financing portal similar to ours and DealerAccess. This acquisition will further enhance our ability to provide leading technology solutions to the Canadian automotive finance industry and expand our dealer and financing source customer base in Canada.

In connection with the Curomax business combination we originally recorded in purchase accounting an estimated restructuring liability of $1.5 million relating to employee severance and related benefit costs. During the second quarter, we paid $0.4 million of employee severance and related benefit costs and also recorded an adjustment of $0.2 million to reduce the restructuring liability and the cost of the purchase. As of June 30, 2007, we have not yet completed all of the workforce reductions and the remaining liability is $0.9 million, which is expected to be paid by December 31, 2007. The estimated liability may change subsequent to its initial recognition, requiring adjustments to the purchase price recorded.

This acquisition was recorded under the purchase method of accounting, resulting in the total purchase price being allocated to the assets acquired and liabilities assumed according to their estimated fair values at the date of acquisition as follows (in thousands):

Current assets	$ 2,454
Property and equipment	339
Intangible assets	21,670
Goodwill	19,926
Total assets acquired	44,389
Total liabilities assumed	(5,424)
Net assets acquired	$ 38,965

Total liabilities assumed includes a $3.9 million deferred tax liability that relates to the amortization of acquired intangibles.

We allocated the amounts to intangible assets and goodwill based on fair value appraisals as follows: approximately $17.2 million of the purchase price has been allocated to customer contracts, $0.8 million to purchased technology and $3.7 million to non-compete agreements. These intangibles are being amortized on a straight-line basis over one to four years based on each intangible s estimated useful life. We also recorded approximately $19.9 million in goodwill, which represents the remainder of the excess of the purchase price over the fair value of the net assets acquired.

The results of Curomax were included in our consolidated statements of operations from the date of acquisition.

Arkona Acquisition

On June 6, 2007, we completed the purchase of all of the outstanding shares of Arkona, Inc. (Arkona) for a cash purchase price of approxim