DealerTrack Holdings, Inc.
Form 10-Q
May 08, 2009

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, 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 April 30, 2009, 40,120,802 shares of the registrant s common stock were outstanding.

DEALERTRACK HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

DEALERTRACK HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

	March 31, 2009	December 31, 2008
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 148,656	$ 155,456
Short-term investments	12,992	43,350
Accounts receivable, net of allowances of $3,425 and $1,848 at March 31, 2009 and December 31, 2008, respectively	21,355	18,462
Prepaid expenses and other current assets	14,070	9,624
Deferred tax assets	2,216	2,195
Restricted cash	28	142
Total current assets	199,317	229,229
Long-term investments	3,626	4,392
Property and equipment, net	14,266	13,448
Software and web site developments costs, net	14,409	12,705
Intangible assets, net	55,429	44,405
Goodwill	129,362	114,886
Restricted cash	250	250
Deferred taxes and other long-term assets	21,513	17,900
Total assets	$ 438,172	$ 437,215
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 3,477	$ 4,488
Accrued compensation and benefits	5,863	7,850
Accrued other	12,867	11,385
Deferred revenues	5,314	5,609
Due to acquirees	591	1,740
Capital leases payable	365	360
Total current liabilities	28,477	31,432
Capital leases payable long-term	357	454

Due to acquirees long-term	722	682
Deferred tax liabilities long-term	5,069	2,477
Deferred revenue and other long-term liabilities	5,655	5,950
Total liabilities	40,280	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 March 31, 2009 and December 31, 2008		
Common stock, $0.01 par value: 175,000,000 shares authorized; 43,060,255 shares issued and 40,023,759 shares outstanding at March 31, 2009; and 175,000,000 shares authorized; 42,841,737 shares issued and 39,833,616 shares outstanding at December 31, 2008	431	428
Treasury stock, at cost, 3,036,496 shares and 3,008,121 shares at March 31, 2009 and December 31, 2008, respectively	(50,386)	(50,061)
Additional paid-in capital	437,642	428,771
Deferred stock-based compensation (APB 25)	(144)	(446)
Accumulated other comprehensive income	(4,284)	(2,730)
Retained earnings	14,633	20,258
Total stockholders equity	397,892	396,220
Total liabilities and stockholders equity	$ 438,172	$ 437,215

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

Table of Contents

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

	Three Months Ended March 31, 2009	2008
	(In thousands, except share and per share amounts)	
Revenue		
Net revenue	$ 55,700	$ 64,308
Operating costs and expenses		
Cost of revenue (1)	29,121	28,612
Product development (1)	4,132	3,142
Selling, general and administrative (1)	32,318	29,732
Total operating costs and expenses	65,571	61,486
(Loss) income from operations	(9,871)	2,822
Interest income	402	1,563
Other income	50	
Interest expense	(50)	(92)
Gain on available for sale securities	463	
(Loss) income before benefit (provision) for income taxes	(9,006)	4,293
Benefit (provision) for income taxes, net	3,381	(1,955)
Net (loss) income	$ (5,625)	$ 2,338
Basic net (loss) income per share applicable to common stockholders (2)	$ (0.14)	$ 0.05
Diluted net (loss) income per share applicable to common stockholders (2)	$ (0.14)	$ 0.05
Weighted average shares outstanding (2)	39,095,730	41,637,585
Weighted average shares outstanding assuming dilution (2)	39,095,730	42,805,884

(1) Stock-based compensation expense recorded for the three months ended March 31, 2009 and 2008 was

classified as follows:

	Three Months Ended March 31, 2009	2008
Cost of revenue	$ 613	$ 614
Product development	210	177
Selling, general and administrative	6,583	2,670

(2) Basic and diluted income per share amounts for the three months ended March 31, 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.

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

Table of Contents

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

	Three Months Ended March 31, 2009	2008
	(In thousands)	
Cash flows from operating activities		
Net (loss) income	$ (5,625)	$ 2,338
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities		
Depreciation and amortization	8,775	10,522
Deferred tax benefit	(3,359)	(526)
Stock-based compensation expense	7,406	3,461
Provision for doubtful accounts and sales credits	2,458	1,539
Gain on sale of property and equipment	(166)	
Amortization of bond premium	40	
Amortization of deferred interest	34	50
Non cash deferred compensation	75	62
Amortization of bank financing costs		30
Stock-based compensation windfall tax benefit	(829)	(96)
Gain on available for sale securities	(463)	
Changes in operating assets and liabilities, net of effects of acquisitions		
Trade accounts receivable	(5,415)	(1,803)
Prepaid expenses and other current assets	(3,977)	(56)
Accounts payable and accrued expenses	259	(7,818)
Deferred revenue and other current liabilities	371	873
Other long-term liabilities	(336)	175
Deferred rent	41	234
Other long-term assets	(448)	(2)
Net cash (used in) provided by operating activities	(1,159)	8,983
Cash flows from investing activities		
Capital expenditures	(1,273)	(1,044)
Other restricted cash	114	
Purchase of investments		(44,000)
Sale of investments	31,300	195,080
Capitalized software and web site development costs	(3,050)	(1,537)
Proceeds from sale of property and equipment	71	2
Payment for acquisition of businesses and intangible assets, net of acquired cash	(33,808)	(1,599)
Net cash (used in) provided by investing activities	(6,646)	146,902

Cash flows from financing activities				
Principal payments on capital lease obligations		(92)		(458)
Proceeds from the exercise of employee stock options		935		444
Proceeds from employee stock purchase plan		342		681
Purchase of treasury stock		(325)		(53)
Principal payments on notes payable		(212)		
Stock-based compensation windfall tax benefit		829		96
Net cash provided by financing activities		1,477		710
Net (decrease) increase in cash and cash equivalents		(6,328)		156,595
Effect of exchange rate changes on cash and cash equivalents		(472)		(412)
Cash, beginning of period		155,456		50,564
Cash, end of period	$	148,656	$	206,747
Supplemental disclosure				
Cash paid for:				
Income taxes	$	2,173	$	385
Interest		16		42
Non-cash investing and financing activities:				
Asset sale through note receivable		500		
Accrued capitalized hardware, software and fixed assets		873		333
Goodwill adjustment		(12)		
Deferred compensation reversal to equity		75		63

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

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 March 31, 2009, consisted of approximately 19,000 dealers, over 730 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 March 31, 2009 and for the three months ended March 31, 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 months ended March 31, 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.

3. Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) released staff position SFAS No. 157-4, *Determining Whether a Market is Not Active and a Transaction is Not Distressed* (SFAS No. 157-4). This provides additional guidance in determining whether a market for a financial asset is not active and a transaction is not distressed for fair value measurement purposes as defined in SFAS No. 157, *Fair Value Measurements*. SFAS No. 157-4 is effective for interim periods ending after June 15, 2009, but early adoption is permitted for interim periods ending after March 15, 2009. We are currently evaluating the impact that this statement will have on our consolidated financial statements.

In April 2009, the FASB released staff position SFAS No. 115-2, and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This provides guidance in determining whether impairments in debt securities are other than temporary, and modifies the presentation and disclosures surrounding such instruments. This staff position is effective for interim periods ending after June 15, 2009, but early adoption is permitted for interim periods ending after March 15, 2009. We are currently evaluating the impact that this statement will have on our consolidated financial statements.

In June 2008, the FASB issued FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* (FSP No. EITF 03-6-1), which clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends, or dividend equivalents, before vesting should be considered participating securities. As participating securities, these instruments should be included in the calculation of basic EPS. FSP No. EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Once effective, all prior-periods EPS data presented must be adjusted retroactively to conform with the provision of the FSP. We have adopted the provisions of FSP No. EITF 03-6-1 as of January 1, 2009. For further information about the adoption of the provisions of FSP No. EITF 03-6-1 refer to Note 5.

Table of Contents

In April 2008, the FASB issued FSP SFAS No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP SFAS No. 142-3). FSP SFAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. The intent of FSP SFAS No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under other accounting principles generally accepted in the United States. FSP SFAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The guidance for determining the useful life of a recognized intangible asset is to be applied prospectively. We have adopted the provisions of FSP SFAS No. 142-3 as of January 1, 2009. For further information about the adoption of the provisions of FSP SFAS No. 142-3 refer to Note 8.

In February 2008, the FASB issued FSP SFAS No. 157-2, *Effective Date of FASB Statement 157* (FSP SFAS No. 157-2), 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). The provisions of FSP SFAS No. 157-2 are effective January 1, 2009. The adoption of this statement did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS No. 141R), which replaced SFAS No. 141. SFAS No. 141R retains the fundamental requirements of SFAS No. 141, but revises certain principles, including the definition of a business combination, the recognition and measurement of assets acquired and liabilities assumed in a business combination, the accounting for acquired contingencies, the accounting for goodwill, and financial statement disclosure. We have adopted the provisions of SFAS No. 141R as of January 1, 2009. For further information about the adoption of the provisions of SFAS No. 141R refer to Note 8.

4. Fair Value Measurements

Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157), defines 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, 2009 (in thousands):

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	March 31, 2009
Cash equivalents (1)	$ 120,683	$	$	$ 120,683
Short-term investments (2)	11,179	1,813		12,992

Long-term investments (3)						3,626		3,626
Total	$	131,862	$	1,813	$	3,626	$	137,301

(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) Level 1 short-term investments consist primarily of tax-advantaged preferred stock of financial institutions, corporate bonds and municipal notes with maturity dates of one year or less, for which we determine fair value through quoted market prices.

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 through March 31, 2009 we recorded a loss in other comprehensive income of $0.2 million on the decreased fair value.

Table of Contents

(3) Level 3 long-term investments consist of auction rate securities (ARS) invested in tax-exempt state government obligations that was valued at par. Our intent is not to hold the $1.6 million of ARS invested in tax-exempt state government obligations to maturity, but rather 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 tax-advantaged preferred stock of a financial institution. It is uncertain whether we will 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.

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 and as a result we recorded a realized gain in the statement of operations of $0.7 million for the three months ended March 31, 2009.

The change in the carrying amount of Level 3 investments for the three months ended March 31, 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
Gain on Level 3 available for sale securities		716
Balance as of March 31, 2009	$	3,626

5. Net (Loss) Income per Share

Effective January 1, 2009, we adopted FSP No. EITF 03-6-1. All prior-periods earnings per share data presented must be 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 described in SFAS No. 128. 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. Under the provisions of SFAS No. 128, basic earnings per share is calculated by dividing net (loss) income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net (loss) income by the weighted average number of common shares outstanding, assuming dilution, during the period.

Table of Contents

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

	Three Months Ended March 31, 2009		Three Months Ended March 31, 2008 (2)	
Numerator:				
Net (loss) income	$	(5,625)	$	2,338
Net income allocated to participating securities under two-class method				(50)
Net (loss) income applicable to common stockholders	$	(5,625)	$	2,288
Denominator:				
Weighted average common stock outstanding (basic)		39,095,730		41,637,585
Common equivalent shares from options to purchase common stock and restricted common stock units (1)				1,168,299
Weighted average common stock outstanding (diluted)		39,095,730		42,805,884
Basic net (loss) income per share	$	(0.14)	$	0.05
Diluted net (loss) income per share	$	(0.14)	$	0.05

(1) Restricted common stock units are not considered participating securities since they do not contain a non-forfeitable right to dividends and have, therefore, not been included in the denominator for basic earnings per share calculations.

(2)

EPS data presented was adjusted retroactively to conform with the provisions of FSP No. EITF 03-6-1. FSP No. EITF 03-6-1 did not have a significant impact on the per share calculations for the three months ended March 31, 2008.

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

	Three Months Ended March 31,	
	2009	**2008 (2)**
Stock options	4,982,840	1,864,893
Restricted stock units	475,938	
Total antidilutive awards	5,458,778	1,864,893

6. Comprehensive (Loss) Income

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

	Three Months Ended March 31,	
	2009	**2008**
Net (loss) income	$ (5,625)	$ 2,338