DealerTrack Holdings, Inc.
Form 10-Q
August 09, 2011

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, 2011

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, including zip code)

(516) 734-3600
Registrant’s telephone number, including area code

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 Website, 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 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):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting

company o

(Do not check if a 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 July 31, 2011, 41,411,298 shares of the registrant's common stock were outstanding.

DEALERTRACK HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2011

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DEALERTRACK HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2011	December 31, 2010
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 70,061	$ 192,563
Investments	655	490
Customer funds	2,960	—
Customer funds receivable	13,593	—
Accounts receivable, net of allowances of $4,356 and $3,258 as of June 30, 2011 and December 31, 2010, respectively	37,127	24,273
Prepaid expenses and other current assets	27,693	17,929
Total current assets	152,089	235,255
Investments — long-term	—	2,254
Property and equipment, net	21,532	18,875
Software and website developments costs, net	34,505	29,875
Intangible assets, net	95,026	23,163
Goodwill	211,937	136,408
Deferred tax assets — long-term	26,357	1,015
Other assets — long-term	12,409	12,118
Total assets	$ 553,855	$ 458,963
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 4,721	$ 5,241
Accrued compensation and benefits	13,985	10,823
Accrued liabilities — other	13,727	12,511
Customer funds payable	16,553	—
Deferred revenue	7,810	5,010
Deferred tax liabilities	—	411
Capital leases payable	359	317
Total current liabilities	57,155	34,313
Capital leases payable — long-term	173	165

Deferred tax liabilities — long-term	38,691	9,488
Deferred revenue — long-term	5,387	3,254
Other liabilities — long-term	3,166	2,826
Total liabilities	104,572	50,046
Commitments and contingencies (Note 14)		
Stockholders' equity		
Preferred stock, $0.01 par value: 10,000,000 shares authorized and no shares issued and outstanding as of June 30, 2011 and December 31, 2010	—	—
Common stock, $0.01 par value: 175,000,000 shares authorized; 44,450,128 shares issued and 41,352,913 shares outstanding as of June 30, 2011; and 175,000,000 shares authorized; 43,748,237 shares issued and 40,673,042 shares outstanding as of December 31, 2010	445	437
Treasury stock, at cost, 3,097,215 shares and 3,075,195 shares as of June 30, 2011 and December 31, 2010, respectively	(51,525)	(51,083)
Additional paid-in capital	475,952	463,614
Accumulated other comprehensive income	9,426	7,858
Retained earnings (accumulated deficit)	14,985	(11,909)
Total stockholders' equity	449,283	408,917
Total liabilities and stockholders' equity	$ 553,855	$ 458,963

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(In thousands, except share and per share amounts)		(In thousands, except share and per share amounts)	
Revenue:				
Net revenue	$89,051	$61,907	$166,242	$118,692
Operating expenses:				
Cost of revenue (1)	49,040	31,265	91,906	61,982
Product development (1)	3,500	3,339	7,242	6,937
Selling, general and administrative (1)	30,633	27,260	62,234	54,668
Total operating expenses	83,173	61,864	161,382	123,587
Income (loss) from operations	5,878	43	4,860	(4,895)
Interest income	84	123	188	249
Interest expense	(212)	(60)	(244)	(119)
Other income	92	276	266	900
Realized gain on securities	409	—	409	582
Income (loss) before (provision for) benefit from income taxes	6,251	382	5,479	(3,283)
(Provision for) benefit from income taxes, net	(4,085)	(499)	21,415	715
Net income (loss)	$2,166	$(117)	$26,894	$(2,568)
Basic net income (loss) per share	$0.05	$(0.00)	$0.66	$(0.06)
Diluted net income (loss) per share	$0.05	$(0.00)	$0.64	$(0.06)
Weighted average common stock outstanding (basic)	41,202,939	40,271,983	41,035,681	40,182,567
Weighted average common stock outstanding (diluted)	42,550,398	40,271,983	42,279,986	40,182,567

(1) Stock-based compensation expense recorded for the three and six months ended June 30, 2011 and 2010 was classified as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Cost of revenue	$425	$438	$852	$841
Product development	187	156	372	307
Selling, general and administrative	2,414	2,493	4,744	4,681

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

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

	Six Months Ended June 30, 2011	2010
	(In thousands)	
Operating Activities:		
Net income (loss)	$ 26,894	$ (2,568)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	24,739	18,304
Deferred tax benefit	(23,707)	(3,942)
Stock-based compensation expense	5,968	5,829
Provision for doubtful accounts and sales credits	3,331	2,807
Amortization of deferred interest	—	68
Deferred compensation	100	—
Stock-based compensation windfall tax benefit	(1,890)	(894)
Realized gain on securities	(409)	(582)
Amortization of debt issuance costs	91	—
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(11,583)	(8,316)
Customer funds and customer funds receivable	(6,060)	—
Prepaid expenses and other current assets	(4,777)	(3,783)
Accounts payable and accrued expenses	(8,237)	(8,232)
Customer funds payable	6,060	—
Deferred revenue	1,427	(9)
Other liabilities — long-term	147	290
Deferred rent	67	(24)
Other assets — long-term	144	(12,307)
Net cash provided by (used in) operating activities	12,305	(13,359)
Investing Activities:		
Capital expenditures	(5,571)	(9,852)
Sale of investments	2,485	1,419
Capitalized software and website development costs	(9,657)	(6,435)
Payment for acquisition of businesses, net of acquired cash	(128,311)	(3,028)
Net cash used in investing activities	(141,054)	(17,896)
Financing Activities:		
Principal payments on capital lease obligations	(299)	(260)
Proceeds from the exercise of employee stock options	4,386	396
Proceeds from employee stock purchase plan	340	413
Purchase of treasury stock	(441)	(595)
Stock-based compensation windfall tax benefit	1,890	894
Net cash provided by financing activities	5,876	848

Net decrease in cash and cash equivalents		(122,873)		(30,407)
Effect of exchange rate changes on cash and cash equivalents		371		(141)
Cash and cash equivalents, beginning of period		192,563		197,509
Cash and cash equivalents, end of period	$	70,061	$	166,961
Supplemental Disclosure:				
Cash paid for:				
Income taxes	$	4,465	$	3,954
Interest		32		33
Non-cash investing and financing activities:				
Accrued capitalized hardware, software and fixed assets		1,004		2,977
Assets acquired under capital leases		34		289
Capitalized stock-based compensation		67		34
Deferred compensation reversal to equity		100		—

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

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

1. Business Description and Basis of Presentation

Business Description

DealerTrack's intuitive and high-value software solutions and services enhance efficiency and profitability for all major segments of the retail automotive industry, including dealers, lenders, OEM's, agents and aftermarket providers. We believe our solution set for dealers is the industry's most comprehensive. DealerTrack operates the industry's largest online credit application network in the United States, connecting over 17,000 dealers with more than 1,000 lenders. Our dealer management system (DMS) provides dealers with easy-to-use tools and real-time data access to enhance their efficiency, while our inventory offerings provide vehicle inventory management and merchandising solutions to help dealers drive higher in-store and online traffic with state-of-the-art, real-time listings — leading to accelerated used-vehicle turn rates and higher dealer profits. Our sales and F&I (finance & insurance) solutions allow dealers to streamline the entire sales process as they structure deals from a single integrated platform. DealerTrack's compliance solution helps dealers meet legal and regulatory requirements and protect their assets. DealerTrack also offers additional solutions for the automotive industry including electronic motor vehicle registration and titling applications, paper title storage, and digital document services. DealerTrack's family of companies also includes data and consulting services providers, ALG and Chrome Systems.

Basis of Presentation

The accompanying unaudited consolidated financial statements for the three and six months ended June 30, 2011 and 2010 have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not necessarily include all information and footnotes necessary for a fair statement of its consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States (GAAP). The December 31, 2010 consolidated balance sheet information has been derived from the audited financial statements at that date but does not include all disclosures required by GAAP.

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, which are normal and recurring, necessary for a fair statement of a statement of results of operations, financial position and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission (SEC) on February 18, 2011. Operating results for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2011.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts and the disclosures of contingent amounts in our financial statements and the accompanying notes. Actual results could differ from those estimates.

2. Significant Accounting Policies

Our significant accounting policies are those that we believe are both important to the portrayal of our financial condition and results of operations. Management believes there have been no material changes to the significant accounting policies discussed in Note 2 of our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on February 18, 2011, except as set forth below as it relates to the acquisition of triVIN Holdings, Inc., now known as DealerTrack Processing Solutions, Inc. (DealerTrack Processing Solutions):

Revenue Recognition

Collateral Management Services Transaction Revenue

Our collateral management solution provides paper and electronic-based title services. Customer contracts are principally comprised of two elements: (1) title perfection and (2) title administration.

Collateral management services are delivered either manually (for paper-based) or electronically. Paper-based title management services require us to physically hold, store and manually release the title. Electronic title management services require an electronic title and data storage; the release of the title can be accomplished by the lien holder and does not require manual action by us.

Deliverables for paper and electronic title management arrangements are separated into more than one unit of accounting when (i) the delivered element(s) have value to the customer on a stand-alone basis, (ii) delivery of the undelivered element(s) is probable and substantially in our control, and (iii) evidence of fair value is available.

Based on the above criteria, both paper and electronic-based collateral management service revenue is separated into two units of accounting. We recognize a portion of the paper-based transaction fee upon completion of the lien documentation and for electronic-based transactions upon receipt of the title record. For customers in which we bill the entire transaction fee in advance, a portion of both the paper and electronic-based transaction fee is deferred and recognized over the title administration period, which we estimate to be at 39 months. Amounts allocated to each unit of accounting are based upon the price charged when each element is sold separately.

Collateral management services revenue also includes revenue earned from converting a new lender's title portfolio to our collateral management solution and other ancillary services. Amounts earned from converting a new lender's portfolio are recognized over the lender's estimated portfolio loan life which varies depending on the lender. Amounts earned from other ancillary services are recognized on a per transaction basis after services have been rendered.

Registration and Titling Services Transaction Revenue

Our registration and titling services solution provides various web-based and service-bureau automotive vehicle registration services to customers. Registration and titling services revenue is recognized on a per transaction basis after services have been rendered.

Customer Funds

Under contractual arrangements, our registration and titling services solution collects funds from its customers and remits such amounts to the various state departments of motor vehicle registries (registries). Customer funds receivable primarily represents transactions processed by our customers for which we have not collected our fees or the fees payable to the various registries. In addition, payments made to the various registries in advance of receipt from the customer, are recorded as customer funds receivable. Customer funds payable primarily includes transactions processed by our customers for which we have not remitted the fees to the various registries. Customer funds are maintained in separate bank accounts and are segregated from our operating cash.

3. Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued guidance resulting in common fair value measurement disclosure requirements between U.S. GAAP and International Financial Reporting Standards. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and disclosing information about fair value measurements. Some of the requirements clarify the FASB's intent about the application of existing fair value measurement requirements while other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this guidance are effective prospectively for interim and annual periods beginning after December 15, 2011, with no early adoption permitted. This standard will be effective for us beginning with the quarter ended March 31, 2012. We do not expect the adoption to have a material impact on our consolidated financial statements.

In June 2011, the FASB issued guidance that improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in this guidance require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from other comprehensive income to net income, in both net income and other comprehensive income. The standard does not change the current option for presenting components of other comprehensive income gross or net of the effect of income taxes, provided that such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, the standard does not affect the calculation or reporting of earnings per share. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively, with early adoption permitted. This standard will be effective for us beginning with the quarter ended March 31, 2012. We do not expect the adoption to have a material impact on our consolidated financial statements.

4. Fair Value Measurements

Fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a 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 value 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 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.

Financial assets measured at fair value on a recurring basis include the following as of June 30, 2011 and December 31, 2010 (in thousands):

As of June 30, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	June 30, 2011
Cash equivalents (1)	$ 5,119	$ —	$ —	$ 5,119
Short-term investments (2) (3)	205	—	450	655
Total	$ 5,324	$ —	$ 450	$ 5,774

As of December 31, 2010	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	December 31, 2010
Cash equivalents (1)	$ 139,010	$ —	$ —	$ 139,010
Short-term investments (2) (3)	40	—	450	490
Long-term investments (4)	—	—	2,254	2,254
Total	$ 139,050	$ —	$ 2,704	$ 141,754

(1) Cash equivalents consist 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 June 30, 2011 and December 31, 2010, Level 1 short-term investments include investments in tax-advantaged preferred securities, for which we determined fair value based on the quoted market prices of underlying securities.

(3) Level 3 short-term investments include an auction rate security invested in a tax-exempt state government obligation that was valued at par with a value of $0.4 million, or 0.1% of our total assets, as of both June 30, 2011 and December 31, 2010. Our intent is not to hold the auction rate security invested in a tax-exempt state government obligation to maturity, but rather to use the interest reset feature to provide liquidity. However, should the marketplace auctions continue to fail we may hold the security to maturity, which is September 2011. In October 2010, $1.1 million of this security was redeemed by the issuer at par.

(4) Level 3 long-term investments as of December 31, 2010 included a tax-advantaged preferred stock of a financial institution with a fair value of $2.3 million, or 0.5% of total assets. As of December 31, 2010, it was uncertain whether we would be able to liquidate these securities within the next twelve months; as such we classified them as long-term on our

consolidated balance sheet. Due to the lack of observable market quotes we utilized valuation models that relied 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. In June 2011, we sold this security for approximately $2.5 million and recorded a gain of approximately $0.4 million in our consolidated statement of operations.

A reconciliation of the beginning and ending balances for Level 3 investments as of June 30, 2011 and December 31, 2010, is as follows (in thousands):

Balance as of January 1, 2010	$	3,971
Unrealized loss on securities recorded in other comprehensive income		(167)
Partial redemption of auction rate security (3)		(1,100)
Balance as of December 31, 2010		2,704
Sale of tax-advantaged preferred stock (4)		(2,485)
Realized gain on securities included in the statement of operations (4)		409
Reversal of unrealized gain on securities sold recorded in other comprehensive income		(178)
Balance as of June 30, 2011	$	450

5. Net Income (Loss) Per Share

We compute net income (loss) per share in accordance with FASB ASC Topic 260, “Earnings Per Share” (“ASC Topic 260”). Under ASC Topic 260, 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 by the weighted average number of common shares outstanding, assuming dilution, during the period. The diluted earnings per share calculation assumes (i) all stock options which are in the money are exercised at the beginning of 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 if dilutive and if their conditions have (a) 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 (loss) per share for the three and six months ended June 30, 2011 and 2010 (in thousands, except share and per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Numerator:				
Net income (loss)	$ 2,166	$ (117)	$ 26,894	$ (2,568)
Denominator:				
Weighted average common stock outstanding (basic)	41,202,939	40,271,983	41,035,681	40,182,567
Common equivalent shares from options to purchase common stock and restricted common stock units	1,347,459	—	1,244,305	—
Weighted average common stock outstanding (diluted)	42,550,398	40,271,983	42,279,986	40,182,567
Basic net income (loss) per share	$ 0.05	$ (0.00)	$ 0.66	$ (0.06)
Diluted net income (loss) per share	$ 0.05	$ (0.00)	$ 0.64	$ (0.06)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Stock options	1,163,365	5,051,340	1,240,235	4,829,268
Restricted stock units	42,640	829,041	249,118	747,810
Performance stock units	—	80,513	71,988	50,710
Total antidilutive awards	1,206,005	5,960,894	1,561,341	5,627,788

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6. Comprehensive Income (Loss)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net income (loss)	$ 2,166	$ (117)	$ 26,894	$ (2,568)
Foreign currency translation adjustments	400	(2,069)	1,581	(659)
Unrealized gain (loss) on securities	77	(12)	165	3
Reversal of unrealized gain on securities sold	(314)	—	(178)	(589)
Total comprehensive income (loss)	$ 2,329	$ (2,198)	$ 28,462	$ (3,813)

For the three and six months ended June 30, 2011 and 2010, the foreign currency translation adjustment primarily represents the effect on translating the intangibles and goodwill related to previous acquisitions in Canada.

7. Stock-Based Compensation Expense

Stock-based compensation is measured at the grant date based on the fair value of the award, and recognized as an expense over the requisite service period, net of an estimated forfeiture rate. We have four types of stock-based compensation programs: stock options, restricted common stock, restricted stock units, and performance stock units. For further information see Notes 2 and 11 included in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the SEC on February 18, 2011.

The following summarizes stock-based compensation expense recognized for the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Stock options	$ 1,207	$ 1,552	$ 2,500	$ 3,025
Restricted common stock	70	548	288	1,114
Restricted stock units	1,427	808	2,654	1,473
Performance stock units	322	179	526	217
Total stock-based compensation expense	$			