Dealertrack Technologies, Inc
Form 10-Q
May 09, 2013

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, 2013

OR

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

Commission File Number 000-51653

Dealertrack Technologies, 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:

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, 2013, 43,489,142 shares of the registrant’s common stock were outstanding.

DEALERTRACK TECHNOLOGIES, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

DEALERTRACK TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2013	**December 31, 2012**
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$131,577	$143,811
Marketable securities	39,284	34,031
Customer funds	3,540	1,999
Customer funds receivable	22,613	14,077
Accounts receivable, net of allowances of $4,540 and $4,558 as of March 31, 2013 and December 31, 2012, respectively	48,225	43,679
Deferred tax assets, net	4,412	4,412
Prepaid expenses and other current assets	24,439	19,142
Total current assets	274,090	261,151
Marketable securities – long-term	4,383	4,428
Property and equipment, net	27,523	27,407
Investments	122,927	122,808
Software and website developments costs, net	48,892	46,182
Intangible assets, net	110,193	117,599
Goodwill	270,062	270,646
Deferred tax assets, net	44,316	43,611
Other assets — long-term	14,790	16,684
Total assets	$917,176	$910,516
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities		
Accounts payable	$10,008	$18,834
Accrued compensation and benefits	10,080	15,148
Accrued liabilities — other	19,207	16,870

Customer funds payable	26,153	16,076
Deferred revenue	7,884	7,959
Deferred tax liabilities	3,088	3,031
Due to acquirees	11,281	11,124
Total current liabilities	87,701	89,042
Deferred tax liabilities	76,879	77,368
Deferred revenue	5,568	5,525
Senior convertible notes, net	164,228	162,279
Other liabilities	3,467	4,985
Total long-term liabilities	250,142	250,157
Total liabilities	337,843	339,199
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 March 31, 2013 and December 31, 2012	—	—
Common stock, $0.01 par value; 175,000,000 shares authorized; 46,632,019 shares issued and 43,482,525 shares outstanding as of March 31, 2013; and 45,998,679 shares issued and 42,870,061 shares outstanding as of December 31, 2012	466	460
Treasury stock, at cost; 3,149,494 shares and 3,128,618 shares as of March 31, 2013 and December 31, 2012, respectively	(53,076)	(52,398)
Additional paid-in capital	551,878	541,948
Accumulated other comprehensive income	6,419	7,627
Retained earnings	73,646	73,680
Total stockholders’ equity	579,333	571,317
Total liabilities and stockholders’ equity	$917,176	$910,516

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

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DEALERTRACK TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended March 31,	
	2013	2012
	(In thousands, except per share amounts)	
Revenue:		
Net revenue	$109,059	$91,617
Operating expenses:		
Cost of revenue	63,188	53,150
Product development	3,630	2,994
Selling, general and administrative	41,490	34,128
Total operating expenses	108,308	90,272
Income from operations	751	1,345
Interest income	124	230
Interest expense	(3,364)	(1,157)
Other income, net	66	76
Gain on disposal of subsidiary	—	27,693
Earnings from equity method investment, net	1,219	163
(Loss) income before benefit from (provision for) income taxes, net	(1,204)	28,350
Benefit from (provision for) income taxes, net	1,170	(11,389)
Net (loss) income	$(34)	$16,961
Basic net (loss) income per share	$(0.00)	$0.40
Diluted net (loss) income per share	$(0.00)	$0.39
Weighted average common stock outstanding (basic)	43,173	42,091
Weighted average common stock outstanding (diluted)	43,173	43,720

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

DEALERTRACK TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended March 31,	
	2013	2012
	(In thousands)	
Net (loss) income	$(34)	$16,961
Other comprehensive (loss) income, net of tax		
Foreign currency translation adjustments	(1,320)	980
Net change in unrealized gains on securities	112	33
Other comprehensive (loss) income, net of tax	(1,208)	1,013
Total comprehensive (loss) income	$(1,242)	$17,974

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

DEALERTRACK TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2013	2012
	(In thousands)	
Operating activities:		
Net (loss) income	$(34)	$16,961
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	13,897	11,979
Deferred tax (benefit) provision	(1,158)	10,893
Stock-based compensation expense	3,271	3,330
Provision for doubtful accounts and sales credits	1,682	2,146
Earnings from equity method investment, net	(1,219)	(163)
Deferred compensation	38	38
Stock-based compensation windfall tax benefit	(3,587)	(2,943)
Amortization of deferred interest	279	26
Amortization of debt issuance costs and debt discount	2,302	703
Change in contingent consideration	(500)	(250)
Gain on sale of marketable securities	(11)	—
Gain on disposal of subsidiary	—	(27,693)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(6,339)	(6,742)
Prepaid expenses and other current assets	(2,186)	3,059
Other assets — long-term	3,166	1,539
Accounts payable and accrued expenses	(13,518)	(11,441)
Deferred rent	51	48
Deferred revenue	(60)	527
Other liabilities — long-term	(1,074)	(1,166)
Net cash (used in) provided by operating activities	(5,000)	851
Investing activities:		
Capital expenditures	(2,027)	(1,695)
Capitalized software and website development costs	(5,296)	(3,665)
Purchases of marketable securities	(18,037)	—
Proceeds from sales and maturities of marketable securities	12,539	—
Cash contributed for equity method investment	—	(1,750)
Net cash used in investing activities	(12,821)	(7,110)
Financing activities:		
Principal payments on capital lease obligations and financings arrangements	(38)	(349)
Proceeds from stock purchase plan and exercise of stock options	3,109	3,662
Proceeds from the issuance of senior convertible notes	—	200,000

Payments for debt issuance costs	—	(6,690)
Payments for convertible note hedges	—	(43,940)
Proceeds from the issuance of warrants	—	29,740
Purchases of treasury stock	(678)	(657)
Stock-based compensation windfall tax benefit	3,587	2,943
Net cash provided by financing activities	5,980	184,709
Net (decrease) increase in cash and cash equivalents	(11,841)	178,450
Effect of exchange rate changes on cash and cash equivalents	(393)	385
Cash and cash equivalents, beginning of period	143,811	78,709
Cash and cash equivalents, end of period	$131,577	$257,544
Supplemental Disclosure:		
Cash paid for:		
Income taxes	$702	$1,109
Interest	1,646	217
Non-cash investing and financing activities:		
Accrued capitalized hardware, software and fixed assets	2,224	1,879
Assets acquired under capital leases and financing arrangements	34	725
Non-cash consideration issued for investment in Chrome Data Solutions	—	42,301

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

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DEALERTRACK TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Business Description and Basis of Presentation

Business Description

Dealertrack's web-based software solutions and services enhance efficiency and profitability for all major segments of the automotive retail industry, including dealers, lenders, OEMs, third-party retailers, agents and aftermarket providers. Dealertrack operates the largest online credit application networks in the United States and Canada. We believe Dealertrack delivers the industry's most comprehensive solution set for automotive retailers, including:

- Dealer Management solutions, which provide independent and franchised dealers with a powerful dealer management system (DMS) featuring easy-to-use tools and real-time data access to enhance their efficiency;

- Sales and F&I solutions, which allow dealers to streamline the in-store and online sales processes as they structure deals from a single integrated platform;

- Inventory solutions, which deliver vehicle inventory management and transportation offerings to help dealers accelerate used-vehicle turn rates and assist with the facilitation of vehicle delivery;

- Processing solutions, which include online motor vehicle registration, lien and titling applications and services, and collateral management services;

- Digital Retailing solutions, which integrate advanced vehicle search, pricing and payment tools directly into a retailer's website; and

- Interactive solutions, which deliver digital marketing and website offerings to assist dealers in achieving higher lead conversion rates by helping optimize the maximum amount of shoppers to their websites.

References in this Form 10-Q to “Dealertrack,” the “Company,” “our” or “we” are to Dealertrack Technologies, Inc., a Delaware corporation, and/or its subsidiaries.

Basis of Presentation

The accompanying unaudited consolidated financial statements for the three months ended March 31, 2013 and 2012 have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, they do not necessarily include all information and footnotes required by accounting principles generally accepted in the United States (GAAP) for complete financial statements. The December 31, 2012 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 presentation of the statement of results of operations, financial position, other comprehensive income 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, 2012, filed with the Securities and Exchange Commission (SEC) on February 26, 2013. Operating results for the three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2013.

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 consolidated 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, 2012, except as set forth below.

Stock-Based Compensation Expense and Assumptions

Expected Life

As of January 1, 2013, we determine the expected life of any issued stock-based awards based upon our historical exercise patterns and the period of time that the awards are expected to be outstanding. Previously, due to our limited public company history, the expected life was determined based upon the experience of similar entities whose shares are publicly-traded.

Recently Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. We adopted this update in the current quarter. The amounts reclassified out of accumulated other comprehensive income during the three-month period were not material.

3. Fair Value Measurements

Fair value is defined as 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 values are as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 – Unobservable inputs for the asset or liability. 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. There were no transfers between levels of the fair value hierarchy during the periods presented below.

The fair value of our investments in debt securities, reported by the fund managers, are verified by management through the utilization of third party pricing services and review of trades completed around the period end date. We consider market liquidity in determining the fair value for these securities. After completing our validation procedures, we did not adjust any fair value measurements provided by the fund managers. These investments in debt securities are included in Level 2 of the fair value hierarchy below.

Financial assets measured at fair value on a recurring basis include the following as of March 31, 2013 and December 31, 2012 (in thousands):

As of March 31, 2013	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	March 31, 2013
Cash equivalents (1)	$ 39,798	$ —	$ —	$ 39,798
Marketable securities (2)	—	43,667	—	43,667
Total	$ 39,798	$ 43,667	$ —	$ 83,465
Contingent consideration (3)	—	—	(500)	(500)
Total	$ —	$ —	$ (500)	$ (500)

As of December 31, 2012	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**December 31, 2012**
Cash equivalents (1)	$ 63,774	$ —	$ —	$ 63,774
Marketable securities (2)	—	38,459	—	38,459
Total	$ 63,774	$ 38,459	$ —	$ 102,233
Contingent consideration (3)	—	—	(1,000)	(1,000)
Total	$ —	$ —	$ (1,000)	$ (1,000)

A reconciliation of the beginning and ending balance of the contingent consideration, a Level 3 liability, is as follows (in thousands):

Balance as of December 31, 2012	$ (1,000)
Change in fair value of contingent consideration (3)	500
Balance as of March 31, 2013	$ (500)

(1) Cash equivalents consist of highly liquid investments with original maturity dates of three months or less, for which we determine fair value through quoted market prices. As of March 31, 2013 and December 31, 2012, these investments were at least AA rated.

(2) As of March 31, 2013, Level 2 marketable securities (short-term and long-term) include U.S. treasury and agency securities, corporate bonds and non-U.S. government securities. As of December 31, 2012, Level 2 marketable securities (short-term and long-term) include U.S. treasury and agency securities, corporate bonds and municipal bonds. Fair market value was determined based on the quoted market prices of the underlying securities.

(3) In connection with our October 1, 2012 acquisition of ClickMotive, a portion of the purchase price included contingent consideration that is payable in the first quarter of 2014 based upon the achievement of certain performance targets in 2013. The fair value of the contingent consideration is determined based upon probability-weighted revenue forecasts for the underlying period. The contingent consideration is revalued each reporting period, until settled, with the resulting gains and losses recorded in the consolidated statements of operations. We estimated the fair value of the contingent consideration as of March 31, 2013 to be $0.5 million. We recorded income of $0.5 million for the three months ended March 31, 2013 as a result of the decrease in the estimated settlement of the contingent consideration from the estimated amount of $1.0 million as of December 31, 2012.

Senior convertible notes

Our senior convertible notes are shown in the accompanying consolidated balance sheets at their original issuance value, net of unamortized discount, and are not marked to market. The approximate aggregate fair value of our senior convertible notes as of March 31, 2013 and December 31, 2012 were $214.0 million and $211.5 million, respectively. The fair value of the senior convertible notes was estimated on the basis of quoted market prices of similar securities, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

4. Marketable Securities

Our investments in marketable securities are made within the guidelines of our investment policy, which has established guidelines relative to the diversification of our investments and their maturities, with the principle objective of capital preservation, maintaining liquidity, and avoiding concentrations. The following is a summary of available-for-sale securities as of March 31, 2013 (in thousands):

As of March 31, 2013	Aggregate Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
U.S. Treasury and agency securities	$ 17,558	$ 236	$ —	$ 17,794
Non-U.S. government securities	5,116	—	(6)	5,110

Corporate debt securities	20,787	3	(27)	20,763
Total	$ 43,461	$ 239	$ (33)	$ 43,667

As of December 31, 2012	**Aggregate Cost Basis**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Aggregate Fair Value**
U.S. Treasury and agency securities	$ 17,706	$ 20	$ (0)	$ 17,726
Corporate debt securities	20,545	20	(2)	20,563
Municipal securities	170	—	0	170
Total	$ 38,421	$ 40	$ (2)	$ 38,459

As of March 31, 2013, $39.3 million of marketable securities had scheduled maturities of less than one year, and approximately $4.4 million had scheduled maturities of greater than one year but less than two years. In addition, more than half of our marketable securities were AA rated, and all securities had at least an A rating.

Investments in money market and similar short-term investments are recorded on our consolidated balance sheets as cash and cash equivalents.

Amounts reclassified out of accumulated other comprehensive income during the three-month period were not material.

5. Property and Equipment

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

	Estimated Useful Life (Years)	**March 31,** 2013	**December 31,** 2012
Computer equipment	3 – 5	$48,349	$ 47,052
Office equipment	5	4,810	5,245
Furniture and fixtures	5	5,544	5,171
Leasehold improvements	3 – 13	4,795	4,575
Total property and equipment, gross		63,498	62,043
Less: Accumulated depreciation and amortization		(35,975)	(34,636)

Total property and equipment, net	$27,523	$27,407

Depreciation expense related to property and equipment for the three months ended March 31, 2013 and 2012 was $2.6 million and $2.2 million, respectively.

6. Investments

Investments as of March 31, 2013 and December 31, 2012 include the following (in thousands):

	March 31, 2013	December 31, 2012
Cost method investment	$82,690	$82,690
Equity method investment	40,237	40,118
Total investments	$122,927	$122,808

Cost method investment

In consideration for the sale of ALG in 2011, we received an equity interest in TrueCar, as well as a warrant that we subsequently exercised, both of which are included within our cost method investment.

TrueCar's business simplifies and clarifies the car buying process for consumers by providing accurate market information which helps buyers make better, more informed decisions. TrueCar saves consumers time and money by providing price clarity and transparency, while delivering the benefits of higher close rates and vehicle sales to dealers. TrueCar reaches consumers via two channels – direct and indirect. The direct channel is a website that provides vehicle pricing transparency to consumers and dealers and the indirect channel is a private-label affinity buying program for major brands.

We are not aware of factors requiring further assessment of the recoverability of the investment and we do not believe this investment was impaired as of March 31, 2013.

Equity method investment

We record in our consolidated statement of operations fifty percent (50%) of the net income of Chrome Data Solutions. Cash distributions, which are recorded as a reduction of our investment upon receipt, are based on a calculation considering results of operations and cash on hand. Distributions are expected to be received quarterly.

Our earnings from the equity method investment are reduced by amortization expense relating to the basis difference between the book basis of the contributed assets and the fair value of the investment recorded. This basis difference, based upon a valuation of the fair value of contributed assets, is being recorded over the lives of the underlying assets which gave rise to the basis difference, which range from 3 to 10 years. The unrecorded basis difference as of March 31, 2013 is $10.8 million. The amortization of the basis difference to be recorded for the remainder of 2013 is $2.1 million.

The change in our equity method investment for the three months ended March 31, 2013 is as follows (in thousands):

	March 31, 2013
Beginning balance	$40,118
Share of net income	1,925
Amortization of basis difference	(706)
Cash distributions received	(1,100)
Ending balance	$40,237

We incur an annual data license fee payable to Chrome Data Solutions of $0.5 million, which is recorded as cost of revenue. For the three months ended March 31, 2013, we accrued approximately $0.1 million of expense in connection with the annual data license.

Exclusive of the annual data license fee, we incurred expenses of approximately $0.1 million for services received and earned income of approximately $0.1 million for services performed during the three months ended March 31, 2013, related to agreements with Chrome Data Solutions. The amounts were generally recorded as selling, general and administrative expenses and other income, respectively.

The summarized financial information of Chrome Data Solutions is presented below (in thousands):

Condensed Balance Sheet	(Unaudited) March 31, 2013	(Unaudited) December 31, 2012
Current assets	$ 12,370	$ 10,577
Non-current assets	33,826	34,053
Total assets	$ 46,196	$ 44,630
Current liabilities	$ 5,676	$ 5,525
Non-current liabilities	—	226
Total liabilities	$ 5,676	$ 5,751

Condensed Results of Operations

	(Unaudited) Three Months Ended March 31, 2013	2012
Revenue	$11,287	$11,010
Gross profit	7,523	6,521
Net income	3,850	2,319

7. Intangible Assets

Intangible assets are recorded at estimated fair value and are amortized over their estimated useful lives. The gross book value, accumulated amortization and estimated useful lives of the intangible assets were as follows (dollars in thousands):

	March 31, 2013		December 31, 2012		
	Gross Book Value	Accumulated Amortization	Gross Book Value	Accumulated Amortization	Estimated Useful Life (Years)
Customer contracts	$99,196	$ (45,847)	$99,673	$ (43,229)	4-10
Technology	69,620	(25,586)	69,620	(22,369)	2-8
Trade names	9,100	(2,829)	9,100	(2,480)	2-8
Non-compete agreements	7,540	(4,955)	7,540	(4,469)	3-5
State DMV relationships	6,190	(2,236)	6,190	(1,977)	6

Total	$191,646	$ (81,453)	$192,123	$ (74,524)

Amortization expense related to intangibles for the three months ended March 31, 2013 and 2012 was $7.3 million and $6.9 million, respectively.

Amortization expense that will be incurred for the remainder of 2013 and for each of the subsequent four years and thereafter is estimated as follows (in thousands):

Remainder of 2013	$22,242
2014	26,635
2015	23,862
2016	14,890
2017	8,892
Thereafter	13,672
Total	$110,193

8. Goodwill

The change in carrying amount of goodwill for the three months ended March 31, 2013 was as follows (in thousands):

Goodwill, gross, as of December 31, 2012	$270,646
Accumulated impairment losses as of December 31, 2012	—
Goodwill, net, as of December 31, 2012	$270,646
Impact of change in Canadian dollar exchange rate	(584)
Goodwill, gross, as of March 31, 2013	$270,062
Accumulated impairment losses as of March 31, 2013	—
Goodwill, net, as of March 31, 2013	$270,062

9. Senior Convertible Notes

On March 5, 2012, we issued $200.0 million aggregate principal amount of 1.50% senior convertible notes in a private placement. In connection with the offering of the notes, we entered into privately negotiated convertible note hedge transactions with initial purchasers of the notes or their respective affiliates. The notes are senior unsecured obligations, subordinated in right of payment to existing and future secured senior indebtedness. We do not have the right to redeem the notes prior to maturity. The notes will mature on March 15, 2017, unless earlier repurchased or converted. For further information, see Note 19 included in our Annual Report on Form 10-K for the year ended December 31, 2012.

The net carrying amount of the liability component of the notes as of March 31, 2013 and December 31, 2012 consists of the following (in thousands):

	March 31, 2013	December 31, 2012
Principal amount	$200,000	$200,000
Unamortized discount	35,772	37,721
Net carrying value	$164,228	$162,279

Total interest expense associated with the notes consisted of the following for the three months ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012
Cash interest expense (1.50% coupon rate)	$750	$208
Amortization of debt issuance costs and debt discount	2,190	587
Total interest expense	$2,940	$795

As of March 31, 2013, total capitalized debt issuance costs remaining to be amortized to interest expense were $4.4 million.

As of March 31, 2013, the "if-converted value" did not exceed the principal amount of the notes since the closing share price of our common stock was less than the initial conversion price of the notes. It is our intent to settle the par value of the notes in cash and we expect to have the liquidity to do so based upon cash on hand, net cash flows from operations, and our credit facility. As a result, there will be no impact to diluted earnings per share unless the share price of our stock exceeds the conversion price of $37.37, with additional dilution if our stock price exceeds the warrant strike price of $46.18.

10. Business Combinations

Unaudited Pro Forma Summary of Operations

The accompanying unaudited pro forma summary represents our consolidated results of operations as if the contribution of the net assets of Chrome to the Chrome Data Solutions joint venture and the acquisitions of Dealertrack CentralDispatch and ClickMotive had been completed as of January 1, 2011. The unaudited pro forma financial results for 2013 reflect the results for the three months ended March 31, 2013, as well as the effects of the pro forma adjustments for the stated transactions in 2013. The unaudited pro forma financial results for 2012 reflect the results for the three months ended March 31, 2012, as well as the effects of the pro forma adjustments for the stated transactions in both 2013 and 2012. Pro forma results of operations for the November 1, 2012 acquisition of the assets of Ford's iCONNECT DMS has not been presented because it is not material to the consolidated statement of operations. The unaudited pro forma financial information includes the accounting effects of the business combinations, including adjustments to the amortization of intangible assets, professional fees associated with the transactions, and compensation expense related to amounts to be paid for continued employment. The unaudited pro forma information does not necessarily reflect the actual results that would have been achieved, nor is necessarily indicative of our future consolidated results.

	Three Months Ended March 31,	
	2013	2012
	(In thousands, except per share data)	
Net revenue	$109,059	$97,473
Net income	501	17,581
Basic net income per share	0.01	0.42
Diluted net income per share	0.01	0.40

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11. Net (Loss) Income Per Share

We compute net (loss) income 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 (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. 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 (loss) income per share for the three months ended March 31, 2013 and 2012 (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2013	2012
Numerator:		
Net (loss) income	$(34)	$16,961
Denominator:		
Weighted average common stock outstanding (basic)	43,173	42,091
Common equivalent shares from options to purchase common stock, restricted common stock units and performance stock units	—	1,629
Weighted average common stock outstanding (diluted)	43,173	43,720
Basic net (loss) income per share	$(0.00)	$0.40
Diluted net (loss) income per share	$(0.00)	$0.39

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 (in thousands):

Three
Months
Ended March

	31,	
	2013	2012
Stock options	3,829	537
Restricted stock units	910	103
Performance stock units	185	—
Total antidilutive awards	4,924	640

In regards to our senior convertible notes, it is our intent to settle the par value of the notes in cash, and we expect to have the liquidity to do so. As a result, there will be no impact to diluted earnings per share unless the share price of our stock exceeds the conversion price of $37.37, with additional dilution if our share price exceeds the warrant strike price of $46.18. Our share price during the three months ended March 31, 2013 did not exceed the conversion price or warrant strike price and therefore there was no impact to diluted net (loss) income per share.

12. 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 currently have three types of stock-based compensation awards: stock options, restricted stock units and performance stock units. For further information, see Notes 2 and 14 included in our Annual Report on Form 10-K for the year ended December 31, 2012.

The following summarizes stock-based compensation expense by expense category for the three months ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012
Cost of revenue	$692	$635
Product development	168	214
Selling, general and administrative	2,411	2,481
Total stock-based compensation expense	$3,271	$3,330

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13. Income Taxes

We file a consolidated U.S. income tax return and tax returns in various state and local jurisdictions. Certain of our subsidiaries also file income tax returns in Canada. The Canadian Revenue Agency is reviewing our 2009 and 2010 tax return filings. The Internal Revenue Service (IRS) has concluded a review of our consolidated federal income tax returns through December 31, 2007 and is currently reviewing our consolidated federal income tax returns for 2009, 2010 and 2011. New York has concluded their review of our 2006 (amended) and 2007 state tax returns. Our amended return filings in California and Pennsylvania are under review by each of the respective states. In addition, we are appealing Pennsylvania's assessment to our 2007, 2008 and 2009 tax return filings. All of our other significant taxing jurisdictions are closed for years prior to 2008.

The total liability recorded for uncertain tax positions that would affect our effective tax rate upon resolution of the uncertain tax position, as of March 31, 2013 and December 31, 2012, were $0.6 million and $0.5 million, respectively.

Interest and penalties, if any, related to tax positions taken in our tax returns are recorded in interest expense and general and administrative expenses, respectively, in our consolidated statement of operations. As of both March 31, 2013 and December 31, 2012, accrued interest and penalties related to tax positions taken on our tax returns was approximately $0.1 million.

The net benefit from income taxes for the three months ended March 31, 2013 of $1.2 million consisted primarily of $1.3 million of federal income tax benefit, including $0.4 million from research and development credits, $0.4 million of state income tax benefit and $0.5 million of tax expense for our Canadian subsidiary.

14. Commitments and Contingencies

Contingencies

We are a party to a variety of agreements pursuant to which we may be obligated to indemnify the other party with respect to breach of contract, infringement and other matters. Typically, these obligations arise in the context of agreements entered into by us, under which we customarily agree to hold the other party harmless against losses arising from breaches of representations, warranties and/or covenants. In these circumstances, payment by us is generally conditioned on the other party making a claim pursuant to the procedures specified in the particular agreement, which procedures typically allow us to challenge the other party's claims. Further, our obligations under these agreements may be limited to indemnification of third-party claims only and limited in terms of time and/or amount. In some instances, we may have recourse against third parties for certain payments made by us.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. To date, we have not been required to make any material payments. We believe that if we were to incur a loss in any of these matters, it is not probable that such loss would have a material effect on our business or financial condition.

Retail Sales Tax

On an ongoing basis, various tax jurisdictions in the United States conduct reviews or audits regarding the sales taxability of our products. Historically, we have been able to respond to their inquiries without significant additional sales tax liability imposed. However, in the event we are unsuccessful in responding to future inquiries, additional sales tax liabilities may be incurred. If we are obligated to charge sales tax for certain products, we believe our contractual arrangements with our customers obligate them to pay all sales taxes that are levied or imposed by any taxing authority. We currently have $0.9 million of pending assessments in one state. The current matter has been moved to an administrative hearing. We have not accrued for any amounts relating to this assessment or periods subsequent to the assessment period.

Service Credits

Under the terms of the purchase agreement with the seller of the AAX business, the parent company of the seller was granted the right to service credits of $2.5 million, which may be applied against fees that are charged in connection with their purchase of certain future products or services of Dealertrack. These service credits expire on December 31, 2015. The service credits are being recorded as a reduction in revenue as they are utilized. For the three months ended March 31, 2013 and 2012, we recorded contra revenue related to the service credits of $0.3 million, respectively. As of March 31, 2013, approximately $0.3 million of the service credit remains.

Employment Agreements

Pursuant to employment or severance agreements with certain employees, we have a commitment to pay severance of approximately $6.5 million as of March 31, 2013, in the event of termination without cause, as defined in the agreements, as well as certain potential gross-up payments to the extent any such severance payment would constitute an excess parachute payment under the Internal Revenue Code. Additionally, in the event of termination without cause due to a change in control, we would also have a commitment to pay additional severance of $2.4 million as of March 31, 2013.

Legal Proceedings

From time to time, we are a party to litigation matters arising in connection with the normal course of business, none of which is expected to have a material adverse effect on us. In addition to the litigation matters arising in connection with the normal course of our business, we are party to the litigation described below.

DealerTrack, Inc. v. Finance Express et al., CV-06-2335; DealerTrack, Inc. v. RouteOne and Finance Express et al., CV-06-6864; and DealerTrack, Inc. v. RouteOne and Finance Express et al., CV-07-215

On April 18, 2006, we filed a Complaint and Demand for Jury Trial against David Huber, Finance Express LLC (Finance Express), and three of their unnamed dealer customers in the United States District Court for the Central District of California, Civil Action No. CV-06-2335 AG (FMOx). The complaint sought declaratory and injunctive relief, as well as damages, against the defendants for infringement of the U.S. Patent No. 5,878,403 (the ’403 Patent) and 6,587,841 (the ’841 Patent). Finance Express denied infringement and challenged the validity and enforceability of the patents-in-suit.

On October 27, 2006, we filed a Complaint and Demand for Jury Trial against RouteOne LLC (RouteOne), David Huber and Finance Express in the United States District Court for the Central District of California, Civil Action No. CV-06-6864 (SJF). The complaint sought declaratory and injunctive relief as well as damages against the defendants for infringement of the ’403 Patent and the ’841 Patent. On November 28, 2006 and December 4, 2006, respectively, defendants RouteOne, David Huber and Finance Express filed their answers. The defendants denied infringement and challenged the validity and enforceability of the patents-in-suit.

On February 20, 2007, we filed a Complaint and Demand for Jury Trial against RouteOne, David Huber and Finance Express in the United States District Court for the Central District of California, Civil Action No. CV-07-215 (CWx). The complaint sought declaratory and injunctive relief as well as damages against the defendants for infringement of U.S. Patent No. 7,181,427 (the ’427 Patent). On April 13, 2007 and April 17, 2007, respectively, defendants RouteOne, David Huber and Finance Express filed their answers. The defendants denied infringement and challenged the validity and enforceability of the ’427 Patent.

The DealerTrack, Inc. v. Finance Express et al., CV-06-2335 action, the DealerTrack Inc. v. RouteOne and Finance Express et al., CV-06-6864 action and the DealerTrack v. RouteOne and Finance Express et al., CV-07-215 action, described above, were consolidated by the court. A hearing on claims construction, referred to as a “*Markman*” hearing, was held on September 25, 2007. Fact and expert discovery and motions for summary judgment have substantially been completed.

On July 21, 2008 and September 30, 2008, the court issued summary judgment orders disposing of certain issues and preserving other issues for trial.

On July 8, 2009, the court held Claims 1-4 on the ‘427 Patent were invalid for failure to comply with a standard required by the recently decided case in the Court of Appeals of the Federal Circuit of In re Bilski. On August 11, 2009, the court entered into a judgment granting summary judgment for the defendants.

On September 8, 2009, Dealertrack filed a notice of appeal in the United States Court of Appeals for the Federal Circuit in regards to the finding of non-infringement of the ‘841 Patent, the invalidity of the ‘427 Patent, and the claim construction order to the extent that it was relied upon to find the judgments of non-infringement and invalidity. The defendants also appealed certain findings of the District Court. On May 5, 2011, oral arguments on the appeal were held. On January 20, 2012, the Court of Appeals released its decision. The decision reinstated Dealertrack's infringement action against RouteOne and Finance Express on four claims of the '841 patent, found that claims 14, 16 and 17 of the ‘841 Patent were invalid for indefiniteness and upheld the District Court’s decision regarding the invalidity of certain claims of the ‘427 patent. The case was remanded to the district court for further proceedings.

On October 1, 2012, we entered into to a Settlement Agreement with RouteOne which resulted in the dismissal of RouteOne from the case. The case against Finance Express remains.

We believe that the potential liability from this litigation will not have a material effect on our financial position, results of operations or cash flows when resolved in a future period.

15. Segment Information

The segment information provided in the table below is being reported consistent with our method of internal reporting. Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker reviews information at a consolidated level, as such we have one reportable segment. For enterprise-wide disclosure, we are organized primarily on the basis of service lines.

Revenue earned in Canada for the three months ended March 31, 2013 and 2012 was approximately 9% of our total net revenue. Long-lived assets in Canada were $43.1 million and $44.8 million as of March 31, 2013 and December 31, 2012, respectively.

Supplemental disclosure of revenue by service type for the three months ended March 31, 2013 and 2012 is as follows (in thousands):

	Three Months Ended March 31,	
	2013	2012
Transaction services revenue	$61,364	$54,140
Subscription services revenue	42,778	33,281

Other	4,917	4,196
Total net revenue	$109,059	$91,617

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16. Revolving Credit Facility

We have a $125.0 million credit facility which is available for general corporate purposes (including capital expenditures and investments), subject to certain conditions. Our obligations under the credit facility are guaranteed by certain of our existing and future subsidiaries and secured by substantially all of the assets of the company and such subsidiaries. The credit facility matures on March 1, 2017. For further information, see Note 18 included in our Annual Report on Form 10-K for the year ended December 31, 2012.

Debt issuance costs associated with the credit facility amortized to interest expense for the three months ended March 31, 2013 and 2012 were $0.1 million, respectively. As of March 31, 2013, there was $1.8 million of debt issuance costs remaining to be amortized to interest expense. Interest expense related to the commitment fee for the three months ended March 31, 2013 and 2012 were $0.1 million, respectively.

As of March 31, 2013, we had no amounts outstanding under our credit facility and were in compliance with all restrictive covenants and financial ratios.

17. Subsequent Events

On April 1, 2013, we completed the acquisition of the net assets of Casey & Casey NPS, Inc. (doing business as “Auto Title Express”) (Casey & Casey) for $21.2 million in cash, subject to working capital adjustments subsequent to closing. Casey & Casey is Louisiana’s first electronic public license tag agency and the largest provider of electronic vehicle registration, lien and title services, among other related services, in the state.

We expensed approximately $0.4 million of professional fees associated with the acquisition in the three months ended March 31, 2013. We expect an additional expense of approximately $0.1 million of professional fees in the second quarter of 2013.

We are in the process of finalizing the fair value assessment for the acquired assets and liabilities, which is expected to be completed during the second quarter of 2013. Based upon the preliminary valuation, we expect to recognize approximately $12 million of intangibles and $9 million of goodwill as part of the allocation of purchase price. Both the acquired goodwill and intangible assets are deductible for tax purposes.

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Item 2. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements. Certain statements in this Quarterly Report on Form 10-Q are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements involve a number of risks, uncertainties and other factors that could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that could materially affect such forward-looking statements can be found in the sections entitled "Risk Factors" in Part II, Item 1A in this Quarterly Report on Form 10-Q, as well as Part I, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC on February 26, 2013. Investors are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements made herein are only made as of the date hereof and we undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances except as required by law.

Overview

Dealertrack's web-based software solutions and services enhance efficiency and profitability for all major segments of the automotive retail industry, including dealers, lenders, OEMs, third-party retailers, agents and aftermarket providers. Dealertrack operates the largest online credit application networks in the United States and Canada. We believe Dealertrack delivers the industry's most comprehensive solution set for automotive retailers, including:

- Dealer Management solutions, which provide independent and franchised dealers with a powerful dealer management system (DMS) featuring easy-to-use tools and real-time data access to enhance their efficiency;
- Sales and F&I solutions, which allow dealers to streamline the in-store and online sales processes as they structure deals from a single integrated platform;
- Inventory solutions, which deliver vehicle inventory management and transportation offerings to help dealers accelerate used-vehicle turn rates and assist with the facilitation of vehicle delivery;
- Processing solutions, which include online motor vehicle registration, lien and titling applications and services, and collateral management services;

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Digital Retailing solutions, which integrate advanced vehicle search, pricing and payment tools directly into a retailer's website; and

- Interactive solutions, which deliver digital marketing and website offerings to assist dealers in achieving higher lead conversion rates by helping optimize the maximum amount of shoppers to their websites.

We monitor our business performance using a number of measures that are not found in our consolidated financial statements. These measures include the number of active dealers and lenders, active lender to dealership relationships in the Dealertrack network, the number of transactions processed, average transaction price, transaction revenue per car sold, the number of subscribing dealers in the Dealertrack network, and the average monthly subscription revenue per subscribing dealership. We believe that improvements in these metrics will result in improvements in our financial performance over time.

The following table consists of our non-GAAP financial measures and certain other business statistics that management continually monitors (amounts in thousands are GAAP net (loss) income, adjusted earnings before interest, taxes, depreciation and amortization (adjusted EBITDA), adjusted net income, capital expenditure data and transactions processed):

	Three Months Ended March 31,	
	2013	2012
GAAP net (loss) income	$(34)	$16,961
Non-GAAP Financial Measures and Other Business Statistics:		
Adjusted EBITDA (non-GAAP) (1)	$24,229	$19,419
Adjusted net income (non-GAAP) (1)	$12,036	$9,444
Capital expenditures, software and website development costs	$9,581	$7,964
Active dealers in our U.S. network as of end of the period (2)	20,041	18,345
Active lenders in our U.S. network as of end of the period (3)	1,291	1,165
Active lender to dealer relationships as of end of the period (4)	181,578	172,075
Transactions processed (5)	24,106	21,751
Average transaction price (6)	$2.60	$2.53
Transaction revenue per car sold (7)	$8.99	$8.61
Subscribing dealers in U.S. and Canada as of end of the period (8)	17,832	16,143
Average monthly subscription revenue per subscribing dealership (9)	$737	$691

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(1) Adjusted EBITDA is a non-GAAP financial measure that represents GAAP net (loss) income excluding interest, taxes, depreciation and amortization expenses, stock-based compensation, contra-revenue and certain items, as applicable, such as: impairment charges, restructuring charges, impact of acquisition-related activity (including contingent consideration changes, compensation expense, basis difference amortization, and professional service fees), realized gains on sales of previously impaired securities, gains or losses on sales or disposals of subsidiaries and other assets, rebranding expenses and certain other non-recurring items.

Adjusted net income is a non-GAAP financial measure that represents GAAP net (loss) income excluding stock-based compensation expense, the amortization of acquired identifiable intangibles, contra-revenue, and certain items, as applicable, such as: impairment charges, restructuring charges, impact of acquisition-related activity (including contingent consideration changes, compensation expense, basis difference amortization, and professional service fees), realized gains on sales of previously impaired securities, gains or losses on sales or disposals of subsidiaries and other assets, adjustments to deferred tax asset valuation allowances, non-cash interest expense, rebranding expenses and certain other non-recurring items. These adjustments to net (loss) income, which are shown before taxes, are adjusted for their tax impact at their applicable statutory rates.

Adjusted EBITDA and adjusted net income are presented because management believes that they provide additional information with respect to the performance of our fundamental business activities and are also frequently used by securities analysts, investors and other interested parties in the evaluation of comparable companies. We rely on adjusted EBITDA and adjusted net income as primary measures to review and assess the operating performance of our company and management team in connection with our executive compensation plan incentive payments.

Adjusted EBITDA and adjusted net income have limitations as analytical tools and you should not consider them in isolation from, or as a substitute for, analysis of our results as reported under GAAP. Some of these limitations are:

- Adjusted EBITDA and adjusted net income do not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA and adjusted net income do not reflect changes in, or cash requirements for, our working capital needs;
- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and adjusted EBITDA and adjusted net income do not reflect any cash requirements for such replacements;
- Non-cash compensation is and will remain a key element of our overall long-term incentive compensation package, although we exclude it from adjusted net income and adjusted EBITDA when evaluating our ongoing performance for a particular period;
- Adjusted EBITDA and adjusted net income do not reflect the impact of certain charges or gains resulting from matters we consider not to be indicative of our ongoing operations; and
- Other companies may calculate adjusted EBITDA and adjusted net income differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, adjusted EBITDA and adjusted net income should not be considered as measures of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our GAAP results and using adjusted EBITDA and adjusted net income only as supplements to our GAAP results. Adjusted EBITDA and adjusted net income are measures of our performance that are not required by, or presented in accordance with, GAAP. Adjusted EBITDA and adjusted net income are not measurements of our financial performance under GAAP and should not be considered as alternatives to net income, operating income or any other performance measures derived in accordance with GAAP or as alternatives to cash flow from operating activities as a measure of our liquidity.

The following table sets forth the reconciliation of adjusted EBITDA, a non-GAAP financial measure, from net (loss) income, our most directly comparable financial measure, in accordance with GAAP (in thousands):

	Three Months Ended March 31,	
	2013	2012
GAAP net (loss) income	$(34)	$16,961
Interest income	(124)	(230)
Interest expense – cash	1,062	454
Interest expense – non-cash (10)	2,302	703
(Benefit from) provision for income taxes, net	(1,170)	11,389
Depreciation of property and equipment and amortization of capitalized software and website costs	6,581	5,100
Amortization of acquired identifiable intangibles	7,316	6,879
EBITDA (non-GAAP)	15,933	41,256
Adjustments:		
Stock-based compensation	3,271	3,330
Contra-revenue (11)	1,354	1,102
Acquisition-related and other professional fees	483	199
Acquisition-related contingent consideration changes and compensation expense, net (12)	35	178
Integration and other related costs	799	—
Gain on disposal of subsidiary	—	(27,693)
Rebranding expense	1,648	51
Amortization of equity method investment basis difference (13)	706	996
Adjusted EBITDA (non-GAAP)	$24,229	$19,419

The following table sets forth the reconciliation of adjusted net income, a non-GAAP financial measure, from net (loss) income, our most directly comparable financial measure in accordance with GAAP (in thousands):

	Three Months Ended March 31,	
	2013	2012
GAAP net (loss) income	$(34)	$16,961
Adjustments:		
Interest expense – non-cash (not tax-impacted) (10)	2,302	703
Amortization of acquired identifiable intangibles	7,316	6,879
Stock-based compensation	3,271	3,330
Contra-revenue (11)	1,354	1,102
Gain on disposal of subsidiary	—	(27,693)
Acquisition-related and other professional fees	483	199
Acquisition-related contingent consideration changes and compensation expense, net (12)	35	