DealerTrack Holdings, Inc.
Form 10-Q
August 08, 2012

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, 2012

OR

¨ 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 ¨

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 ¨

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 ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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, 2012, 42,651,038 shares of the registrant's common stock were outstanding.

DEALERTRACK HOLDINGS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

DEALERTRACK HOLDINGS, INC.

CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2012	December 31, 2011
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	$216,151	$ 78,709
Marketable securities	37,871	46
Customer funds	2,521	1,097
Customer funds receivable	22,336	18,695
Accounts receivable, net of allowances of $4,092 and $5,102 as of June 30, 2012 and December 31, 2011, respectively	37,761	37,588
Deferred tax assets	9,246	9,171
Prepaid expenses and other current assets	26,946	23,011
Total current assets	352,832	168,317
Marketable securities – long-term	27,678	—
Property and equipment, net	21,374	21,637
Software and website developments costs, net	37,905	37,341
Investments (Note 10)	130,145	89,000
Intangible assets, net	80,893	96,441
Goodwill	192,914	200,840
Deferred tax assets, net	32,433	34,421
Other assets — long-term	15,940	12,356
Total assets	$892,114	$ 660,353
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities		
Accounts payable	$7,484	$ 7,792
Accrued compensation and benefits	12,487	17,915
Accrued liabilities — other	14,460	15,487
Customer funds payable	24,857	19,792

Deferred revenue	8,576	9,115
Deferred tax liabilities	3,448	3,443
Capital leases payable	144	255
Total current liabilities	71,456	73,799
Capital leases payable	99	107
Deferred tax liabilities	79,588	70,087
Deferred revenue	6,043	6,730
Due to acquirees	10,809	10,493
Senior convertible notes, net (Note 18)	158,456	—
Other liabilities	4,598	4,381
Total long-term liabilities	259,593	91,798
Total liabilities	331,049	165,597
Commitments and contingencies (Note 16)		
Stockholders' equity		
Preferred stock, $0.01 par value: 10,000,000 shares authorized and no shares issued and outstanding	—	—
Common stock, $0.01 par value: 175,000,000 shares authorized; 45,766,423 shares issued and 42,641,061 shares outstanding as of June 30, 2012; and 44,957,890 shares issued and 41,858,697 shares outstanding as of December 31, 2011	458	450
Treasury stock, at cost, 3,125,362 shares and 3,099,193 shares as of June 30, 2012 and December 31, 2011, respectively	(52,309)	(51,567)
Additional paid-in capital	530,611	486,284
Accumulated other comprehensive income	6,193	6,363
Retained earnings	76,112	53,226
Total stockholders' equity	561,065	494,756
Total liabilities and stockholders' equity	$892,114	$ 660,353

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,	
	2012	2011	2012	2011
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Revenue:				
Net revenue	$ 96,396	$ 89,051	$ 188,013	$ 166,242
Operating expenses: (1)				
Cost of revenue	53,712	48,565	106,862	92,992
Product development	2,944	3,118	5,938	6,471
Selling, general and administrative	34,067	31,490	68,195	61,975
Total operating expenses	90,723	83,173	180,995	161,438
Income from operations	5,673	5,878	7,018	4,804
Interest income	184	84	414	198
Interest expense	(3,208)	(212)	(4,365)	(244)
Other income (expense), net	(926)	92	(850)	99
Gain on disposal of subsidiary and sale of other assets (Note 9)	5,500	—	33,193	—
Earnings from equity method investment, net	145	—	308	—
Realized gain on securities	—	409	—	409
Income before (provision for) benefit from income taxes, net	7,368	6,251	35,718	5,266
(Provision for) benefit from income taxes, net	(1,443)	(4,085)	(12,832)	21,628
Net income	$ 5,925	$ 2,166	$ 22,886	$ 26,894
Basic net income per share	$ 0.14	$ 0.05	$ 0.54	$ 0.66
Diluted net income per share	$ 0.13	$ 0.05	$ 0.52	$ 0.64
Weighted average common stock outstanding (basic)	42,470	41,203	42,286	41,036
Weighted average common stock outstanding (diluted)	43,957	42,550	43,839	42,280

(1) Stock-based compensation expense recorded for the three and six months ended June 30, 2012 and 2011 was classified as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Cost of revenue	$ 590	$ 425	$ 1,225	$ 852
Product development	206	187	420	372
Selling, general and administrative	2,586	2,414	5,067	4,744

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

DEALERTRACK HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Net income	$ 5,925	$ 2,166	$ 22,886	$ 26,894
Other comprehensive income, net of tax				
Foreign currency translation adjustments	(1,136)	400	(156)	1,581
Unrealized (loss) gain on securities	(47)	77	(14)	165
Reversal of unrealized gain on securities sold	—	(314)	—	(178)
Other comprehensive income	(1,183)	163	(170)	1,568
Total comprehensive income	$ 4,742	$ 2,329	$ 22,716	$ 28,462

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,	
	2012	2011
	(In thousands)	
Operating Activities:		
Net income	$ 22,886	$ 26,894
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	24,927	24,739
Deferred tax provision (benefit)	11,389	(23,707)
Stock-based compensation expense	6,712	5,968
Provision for doubtful accounts and sales credits	3,831	3,331
Earnings from equity method investment, net	(308)	—
Deferred compensation	75	100
Stock-based compensation windfall tax benefit	(4,108)	(1,890)
Gain on disposal of subsidiary and sale of other assets	(33,193)	—
Realized gain on securities	—	(409)
Amortization of debt issuance costs and debt discount	2,981	91
Change in contingent consideration	(900)	—
Change in fair value of warrant	1,000	—
Amortization of deferred interest	164	—
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(7,223)	(11,583)
Prepaid expenses and other current assets	478	(4,086)
Other assets — long-term	4,092	1,362
Accounts payable and accrued expenses	(6,130)	(8,237)
Deferred rent	7	67
Deferred revenue	613	1,427
Other liabilities — long-term	(743)	147
Net cash provided by operating activities	26,550	14,214
Investing Activities:		
Capital expenditures	(4,340)	(5,571)
Capitalized software and website development costs	(9,223)	(9,657)
Proceeds from sale of Chrome-branded asset	5,500	—
Purchases of marketable securities	(70,175)	—
Proceeds from sales and maturities of marketable securities	4,500	2,485
Cash contributed for equity method investment	(1,750)	—
Payment for acquisition of businesses, net of acquired cash	—	(128,311)
Net cash used in investing activities	(75,488)	(141,054)

Financing Activities:		
Principal payments on capital lease obligations and financing arrangements	(445)	(299)
Proceeds from the exercise of employee stock options	5,075	4,386
Proceeds from employee stock purchase plan	376	340
Proceeds from issuance of senior convertible notes	200,000	—
Payments for debt issuance costs	(7,723)	(1,909)
Payments for convertible note hedges	(43,940)	—
Proceeds from issuance of warrants	29,740	—
Purchases of treasury stock	(742)	(441)
Stock-based compensation windfall tax benefit	4,108	1,890
Net cash provided by financing activities	186,449	3,967
Net increase (decrease) in cash and cash equivalents	137,511	(122,873)
Effect of exchange rate changes on cash and cash equivalents	(69)	371
Cash and cash equivalents, beginning of period	78,709	192,563
Cash and cash equivalents, end of period	$ 216,151	$ 70,061
Supplemental Disclosure:		
Cash paid for:		
Income taxes	$ 2,041	$ 4,465
Interest	260	32
Non-cash investing and financing activities:		
Non-cash consideration issued for investment in Chrome Data Solutions (Note 9)	42,301	—
Accrued capitalized hardware, software and fixed assets	1,364	1,004
Assets acquired under capital leases and financing arrangements	725	34
Capitalized stock-based compensation	—	67
Deferred compensation reversal to equity	75	100

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

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

1. Basis of Presentation and Business Description

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. DealerTrack's dealer management system (DMS) solution provides dealers with easy-to-use tools and real-time data access to enhance their efficiency. DealerTrack's Inventory solution offerings provide vehicle inventory management, merchandising, and transportation solutions to help dealers drive higher in-store and online traffic with real-time listings designed to accelerate used-vehicle turn rates and increase dealer profits. DealerTrack's Sales and Finance solutions allow dealers to streamline the entire sales process as they structure deals from a single integrated platform. Our Compliance offering helps dealers meet legal and regulatory requirements, and protect their assets. DealerTrack also offers Processing solutions for the automotive industry, including digital retailing, electronic motor vehicle registration and titling applications, paper title storage, and digital document services.

On June 20, 2012, at our Annual Meeting of Stockholders, our stockholders approved a change in the name of our parent corporation from "DealerTrack Holdings, Inc." to "Dealertrack Technologies, Inc." We expect to make this change during the third quarter of 2012.

Basis of Presentation

The accompanying unaudited consolidated financial statements of DealerTrack Holdings, Inc. (DealerTrack) for the three and six months ended June 30, 2012 and 2011 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, 2011 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 a 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, 2011, filed with the Securities and Exchange Commission (SEC) on February 22, 2012. Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2012.

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.

Beginning in 2012, we are presenting our consolidated statements of operations and our consolidated statements of comprehensive income as two separate but consecutive statements.

Certain previously reported amounts have been revised on the consolidated statement of operations. This includes certain salary and benefits costs, which have been reclassified from product development expenses to cost of revenues. For the six months ended June 30, 2012, we have reclassified approximately $0.6 million of salary and benefit costs. For the three and six months ended June 30, 2011, we have reclassified approximately $0.4 million and $0.8 million of salary and benefit costs, respectively. In addition, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011, certain previously reported amounts have been reclassified on the consolidated statement of operations. These reclassifications did not have a material impact on our previously issued consolidated financial statements.

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, 2011, except as set forth below.

Transaction Revenue

Collateral Management Services Transaction Revenue

Our collateral management solution provides vehicle title and administration services for our customers, which are comprised mainly of lenders, financial institutions and credit unions. The solution facilitates communication between our customers and the state department of motor vehicles by providing a solution for our customers to monitor title perfection and expedite the processing of liens with the state department of motor vehicles. We offer both paper-based and electronic-based title services depending on state requirements. Customer contracts for title services are principally comprised of two elements: (1) title perfection confirmation and (2) title administration.

For paper-based titles, title perfection confirmation occurs upon the receipt of title and lien documentation supporting title perfection from the department of motor vehicles. For electronic-based titles, title perfection confirmation is achieved upon electronic acknowledgement that department of motor vehicles' records reflect the customer as the lien holder.

For paper-based titles, title administration services require us to physically hold, store and manually release the title. For electronic-based titles, title administration services require data storage. The release of the electronic 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) relative selling price is determined.

Based on the above criteria, paper and electronic-based collateral management service revenue are separated into two units of accounting. We recognize a portion of the paper-based transaction fee upon receipt of title and lien documentation supporting title perfection from the department of motor vehicles. For electronic-based titles, we recognize a portion of the fee upon electronic acknowledgement that the department of motor vehicles' records reflect the customer as the lien holder. For paper-based title services, amounts allocated to each unit of accounting are based upon vendor-specific objective evidence. For electronic-based title services, amounts allocated to each unit of accounting are based upon estimated selling price, which is based upon an adjustment to the selling price of our individual paper-based title services, when sold separately. The adjustment to the selling price is due to the lower selling price of electronic-based services compared to paper-based services.

For customers in which we bill the entire transaction fee in advance, the title administration portion of the fee for both paper and electronic-based titles is deferred and recognized over the title administration period, which is estimated at 39 months. This estimate is based upon a historical analysis of the average time period between the date of financing and the date of pay-off.

Collateral management services revenue also includes revenue earned from converting a new lender's title portfolio to our collateral management solution, which may include 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.

Marketable Securities

Marketable securities consist of U.S. treasury and agency securities, corporate bonds, municipal bonds and a tax-advantaged preferred security. All of our marketable securities are classified as available-for-sale securities and are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of accumulated other comprehensive income until realized.

Senior Convertible Notes

In accordance with FASB ASC Topic 470-20, *Debt with Conversion and Other Options* (ASC 470-20), we separately account for the liability and equity components of our senior convertible notes. The estimated fair value of the liability component is computed based on an assessment of the fair value of a similar debt instrument that does not include a conversion feature. The equity component, which is recognized as a debt discount and recorded in additional paid-in capital, represents the difference between the gross proceeds from the issuance of the notes and the estimated fair value of the liability component at the date of issuance. The debt discount is amortized over the expected life of a similar liability without the equity component. The effective interest rate used to amortize the debt discount is based on our estimated non-convertible borrowing rate of a similar liability without an equity component as of the date the notes were issued.

Equity Method Accounting

We apply the equity method of accounting to investments in entities in which we own more than 20% of the equity of the entity and exercise significant influence.

Stock-Based Compensation Expense and Assumptions

Expected Stock Price Volatility

As of January 1, 2012, we determine the expected volatility of any stock-based awards we issue based on our historical volatility. Previously, due to our limited public company history, the expected volatility for stock-based awards was determined using a time-weighted average of our historical volatility and the expected volatility of similar entities whose common shares are publicly-traded.

3. Recent Accounting Pronouncements

In July 2012, the Financial Accounting Standards Board (FASB) issued amended guidance that simplifies how entities may test indefinite-lived intangible assets other than goodwill for impairment. After an assessment of certain qualitative factors, if it is determined to be more likely than not that an indefinite-lived asset is impaired, entities must perform the quantitative impairment test. Otherwise, the quantitative test is optional. The amended guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with

early adoption permitted. 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 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 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 or similar assets or liabilities.
- 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.

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 or override 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 and liabilities measured at fair value on a recurring basis include the following as of June 30, 2012 and December 31, 2011 (in thousands):

As of June 30, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	June 30, 2012
Cash equivalents (1)	$ 120,489	$ —	$ —	$ 120,489
Marketable securities (2)	—	65,549	—	65,549
Investments – long term (3)	—	—	5,500	5,500

Total	$ 120,489	$ 65,549	$ 5,500	$ 191,538
Contingent consideration (4)	—	—	—	—
Total	$ —	$ —	$ —	$ —

As of December 31, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	December 31, 2011
Cash equivalents (1)	$ 6,594	$ —	$ —	$ 6,594
Marketable securities (2)	—	46	—	46
Investments – long term (3)	—	—	6,500	6,500
Total	$ 6,594	$ 46	$ 6,500	$ 13,140
Contingent consideration (4)	—	—	(900)	(900)
Total	$ —	$ —	$ (900)	$ (900)

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(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 June 30, 2012 and December 31, 2011, these investments were at least AA rated.

(2) As of June 30, 2012, Level 2 marketable securities include U.S. treasury and agency securities, corporate bonds, municipal bonds and an investment in a tax-advantaged preferred security. As of December 31, 2011, Level 2 marketable securities include an investment in a tax-advantaged preferred security. Fair market value was determined based on the quoted market prices of the underlying securities.

(3) In connection with our October 1, 2011 disposal of ALG, we acquired a warrant to purchase 6.3 million additional shares of TrueCar common stock and recorded the warrant as a long-term investment. As a result of a net settlement feature, the warrant is revalued each reporting period through its expiration date of October 1, 2012, with the change in fair value recorded in the consolidated statements of operations. The fair value of the warrant is estimated using a Black-Scholes option pricing model. The significant unobservable inputs used in the pricing model are share price, expected volatility, and expected term. An increase (decrease) in any of these individual inputs would result in a significantly higher (lower) estimated fair value measurement. For the three months ended June 30, 2012, the value decreased by $1.0 million due to a decrease in the remaining expected term.

(4) A portion of the purchase price of eCarList included contingent consideration that is payable in the first quarter of 2013 based upon the achievement of certain revenue targets in 2012. 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. As of June 30, 2012, we do not expect to make any contingent consideration payments for the achievement of revenue targets in 2012. We recorded income of $0.7 million and $0.9 million for the three and six months ended June 30, 2012, respectively, as a result of the decrease in the estimated settlement of the contingent consideration from the estimated amount as of December 31, 2011.

A reconciliation of the beginning and ending balances of the warrant, a Level 3 investment, is as follows (in thousands):

Balance as of December 31, 2011	$6,500
Change in fair value of warrant	(1,000)
Balance as of June 30, 2012	$5,500

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

Balance as of December 31, 2011	$(900)
Change in fair value of contingent consideration	900
Balance as of June 30, 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 June 30, 2012 is $212.0 million. 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.

5. 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. Per the investment policy, the weighted average maturity of the collective investments is to approximate three months. The following is a summary of available-for-sale securities as of June 30, 2012 (in thousands):

As of June 30, 2012	Aggregate Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
U.S. Treasury and agency securities	$ 37,741	$ 100	$ (10)	$ 37,831
Corporate debt securities	27,618	—	(76)	27,542
Municipal securities	176	—	—	176
Total	$ 65,535	$ 100	$ (86)	$ 65,549

Available-for-sale securities as of December 31, 2011 consisted of a tax-advantaged preferred security with a fair value of $46 thousand.

As of June 30, 2012, all of our marketable securities were at least A rated, with more than half of our marketable securities being AAA rated.

As of June 30, 2012, $37.9 million of marketable securities had scheduled maturities of less than one year, and approximately $27.7 million had scheduled maturities of greater than one year but less than two years.

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

6. Net Income Per Share

Net income per share is computed in accordance with FASB ASC Topic 260, *Earnings Per Share* (ASC 260). Under ASC 260, basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding, assuming dilution, during the period. The diluted earnings per share calculation assumes (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 per share for the three and six months ended June 30, 2012 and 2011 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Numerator:				
Net income	$ 5,925	$ 2,166	$ 22,886	$ 26,894
Denominator:				

Weighted average common stock outstanding (basic)	42,470	41,203	42,286	41,036
Common equivalent shares from options to purchase common stock and restricted common stock units	1,487	1,347	1,553	1,244
Weighted average common stock outstanding (diluted)	43,957	42,550	43,839	42,280
Basic net income per share	$ 0.14	$ 0.05	$ 0.54	$ 0.66
Diluted net income per share	$ 0.13	$ 0.05	$ 0.52	$ 0.64

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Stock options	724	1,163	620	1,240
Restricted stock units	13	43	197	249
Performance stock units	—	—	—	72
Total antidilutive awards	737	1,206	817	1,561

In regards to our senior convertible notes, it is our intent to settle the par value of the notes in cash. 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. Additional dilution will occur if our stock price exceeds the warrant strike price of $46.18.

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 12 included in our Annual Report on Form 10-K for the year ended December 31, 2011.

The following summarizes stock-based compensation expense recognized for the three and six months ended June 30, 2012 and 2011 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Stock options	$ 1,164	$ 1,207	$ 2,324	$ 2,500
Restricted common stock	—	70	—	288
Restricted stock units	1,722	1,427	3,507	2,654
Performance stock units	496	322	881	526
Total stock-based compensation expense	$ 3,382	$ 3,026	$ 6,712	$ 5,968

8. Business Combinations

Unaudited Pro Forma Summary of Operations

The accompanying unaudited pro forma summary represents our consolidated results of operations as if the acquisitions of DealerTrack Processing Solutions and eCarList, as well as the divestiture of ALG had been completed as of January 1, 2010 and the contribution of the net assets of Chrome to the Chrome Data Solutions joint venture, had been completed as of January 1, 2011. 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 acquisition, interest expense on short-term and long-term debt which was not acquired, compensation expense related to amounts to be paid for continued employment, compensation expense and interest expense related to the eCarList note payable, revenue and costs from commercial arrangements, and data license costs and amortization. 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 June 30, 2011	Six months ended June 30, 2011
	(In thousands, except per share data)	
Net revenue	$ 84,205	$ 161,279
Net income (loss)	939	1,390
Basic net income (loss) per share	0.02	0.03
Diluted net income (loss) per share	0.02	0.03

9. Contribution to Chrome Data Solutions

On January 1, 2012, we completed the series of transactions provided for in the Omnibus Agreement dated December 20, 2011 by and among Chrome Systems, Inc., our wholly-owned subsidiary (Chrome), Autodata Solutions, Inc. (Autodata) and Autodata Solutions Company, subsidiaries of Internet Brands Inc., and AutoChrome Company (the Omnibus Agreement). The Omnibus Agreement provided for the formation of a 50%/50% joint venture named "Chrome Data Solutions" through the organization of (i) a Delaware limited liability company, (ii) a Delaware limited partnership that is a subsidiary of such limited liability company and (iii) a Nova Scotia unlimited liability company (collectively, the Joint Venture), pursuant to which the parties would collaboratively develop, market and sell automotive content products and services. Pursuant to the Omnibus Agreement, the Joint Venture was formed by the following steps, among others: (a) Chrome contributed substantially all of its assets and liabilities to the Joint Venture; (b) Autodata contributed substantially all of the assets and liabilities of its content division (other than assets to be exclusively licensed to the Joint Venture, as described in the following clause (c)) to the Joint Venture; (c) Autodata exclusively licensed certain of its intellectual property to the Joint Venture; (d) DealerTrack received a perpetual, irrevocable license to use certain Joint Venture intellectual property and data in its products and services; and (e) the parties entered into agreements to form and govern the Joint Venture and provide for certain other matters concerning the Joint Venture. The board of the Joint Venture consists of two members from each contributing party, one of which serves as the chair on a rotating basis. As a result of the ownership level and governance, we have significant influence over the operations of the entity, and therefore we account for the investment under the equity method of accounting.

As a result of the contribution, we recognized a pre-tax gain of approximately $27.7 million, calculated as follows (in thousands):

Cash	$1,750
Property and equipment	3,947
Goodwill	7,874
Intangible assets	2,017
Other assets, net	769
Carrying value of contributed net assets of Chrome	16,357
Total consideration received (50% of the fair value of shares received)	44,050
Pre-tax gain	$27,693

For further information on the investment in Chrome Data Solutions, see Note 10.

In a separate transaction, on January 23, 2012, we agreed to sell a Chrome-branded asset, which was not contributed to the joint venture, for $5.5 million. During June 2012, we completed the sale and recorded a pre-tax gain of $5.5 million after performing all of the necessary procedures required as part of the sales agreement. We incurred costs in connection with the sale of this asset of $0.1 million and $0.2 million for the three and six months ended June 30, 2012, respectively.

10. Investments

Investments as of June 30, 2012 and December 31, 2011 consist of the following (in thousands):

	June 30, 2012	December 31, 2011
Cost method investment - TrueCar	$82,500	$ 82,500
Warrant - TrueCar	5,500	6,500
Equity method investment – Joint Venture	42,145	—
Total investments	$130,145	$ 89,000

Cost method investment – TrueCar

On October 1, 2011, we sold our wholly-owned subsidiary, ALG, to TrueCar. In consideration for the sale of ALG, we received an equity interest in TrueCar. 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 June 30, 2012.

Warrant – TrueCar

In connection with the sale of ALG to TrueCar, we acquired a warrant to purchase 6.3 million additional shares of TrueCar common stock. The warrant expires on October 1, 2012. As a result of a net settlement feature, the warrant is revalued each reporting period, with the change in fair value recorded in the consolidated statements of operations. For the three months ended June 30, 2012, the estimated value of the warrant decreased by $1.0 million due to a decrease in the remaining expected term.

Equity method investment – Joint Venture

Commencing on January 1, 2012, we record within our consolidated statement of operations 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 defined calculation considering results of operations and cash flows, 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 $15.5 million and will be 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 June 30, 2012 is $13.5 million. The amortization of the basis difference to be recorded for the remainder of 2012 is $2.0 million and for fiscal year 2013 is $2.8 million.

The activity for our equity method investment for the three and six months ended June 30, 2012 is as follows (in thousands):

	Three months ended June 30, 2012	Six months ended June 30, 2012
Beginning balance	$ 43,359	$ —
Investment	—	44,050
Share of net income	1,141	2,301
Amortization of basis difference	(996)	(1,993)
Cash distributions received	(1,359)	(2,213)
Ending balance	$ 42,145	$ 42,145

In connection with the contribution of the net assets of Chrome to Chrome Data Solutions on January 1, 2012, certain Chrome employees remained employed by DealerTrack through January 31, 2012. Their salary and related benefits were recorded in cost of revenue, product development and selling, general and administrative expenses. The reimbursement for these costs, in the amount of $0.8 million, was recorded as a reduction of selling, general and administrative expenses for the six months ended June 30, 2012.

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 and six months ended June 30, 2012, we accrued approximately $0.1 million and $0.3 million, respectively, of expense in connection with the annual data license. Amounts paid for the data license are generally returned in a cash distribution in the quarter of payment.

In connection with a transitional services agreement with Chrome Data Solutions, during the three and six months ended June 30, 2012, we expensed approximately $0.1 million and $0.2 million, respectively, for services received. In addition, for the three and six months ended June 30, 2012, we recorded income of approximately $0.1 million and $0.1 million, respectively, for services performed. The amounts were generally recorded as selling, general and administrative expenses and other income, respectively. We expect this activity to continue throughout 2012.

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

Condensed Balance Sheet	(Unaudited) June 30, 2012
Current assets	$ 11,561
Non-current assets	33,449

Total assets	$ 45,010
Current liabilities	$ 5,526
Non-current liabilities	322
Total liabilities	$ 5,848

Condensed Results of Operations

	(Unaudited) Three months ended June 30, 2012	(Unaudited) Six months ended June 30, 2012
Sales	$ 11,021	$ 22,031
Gross profit	7,046	13,567
Net income	2,282	4,601

11. Property and Equipment

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

	Estimated Useful Life (Years)	June 30, 2012	December 31, 2011
Computer equipment	3 – 5	$41,221	$ 40,456
Office equipment	5	4,602	4,789
Furniture and fixtures	5	4,272	3,693
Leasehold improvements	3 – 13	3,862	3,545
Total property and equipment, gross		53,957	52,483
Less: Accumulated depreciation		(32,583)	(30,846)
Total property and equipment, net		$21,374	$ 21,637

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Depreciation expense related to property and equipment for the three and six months ended June 30, 2012 and 2011 is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Depreciation expense	$ 2,256	$ 2,246	$ 4,462	$ 4,162

12. 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):

	June 30, 2012		December 31, 2011		
	Gross Book Value	Accumulated Amortization	Gross Book Value	Accumulated Amortization	Estimated Useful Life (Years)
Customer relationships	$74,469	$ (36,373)	$76,191	$ (31,745)	4-7
Database	492	(492)	492	(492)	3-6
Trade names	4,889	(1,933)	4,889	(1,484)	2-7
Technology	62,933	(31,281)	63,900	(25,057)	2-5
Non-compete agreements	6,890	(3,429)	7,299	(2,796)	4-5
State DMV relationships	6,190	(1,462)	6,190	(946)	6
Total	$155,863	$ (74,970)	$158,961	$ (62,520)	

Amortization expense related to intangibles for the three and six months ended June 30, 2012 and 2011 is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Intangible amortization expense	$ 6,653	$ 7,708	$ 13,532	$ 14,568

Amortization expense that will be incurred for the remaining period of 2012 and for each of the subsequent five years and thereafter is estimated as follows (in thousands):

Remainder of 2012	$12,223
2013	22,581
2014	18,955
2015	15,909
2016	7,833
2017	3,049
Thereafter	343
Total	$80,893

13. Goodwill

The change in carrying amount of goodwill for the six months ended June 30, 2012 is as follows (in thousands):

Goodwill, gross, as of December 31, 2011	$200,840
Accumulated impairment losses as of December 31, 2011	—
Goodwill, net, as of December 31, 2011	$200,840
Impact of change in Canadian dollar exchange rate	(52)
Contribution of Chrome goodwill	(7,874)
Goodwill, gross, as of June 30, 2012	$192,914
Accumulated impairment losses as of June 30, 2012	—
Goodwill, net, as of June 30, 2012	$192,914

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14. Accrued Liabilities – Other

A summary of the components of accrued liabilities – other as of June 30, 2012 and December 31, 2011 is as follows (in thousands):

	June 30, 2012	December 31, 2011
Professional fees	$2,634	$ 2,429
Customer deposits	2,343	2,390
Revenue share	1,187	1,651
Sales taxes	1,144	1,093
Software licenses and maintenance contracts	910	1,213
State DMV transaction fees	557	480
Computer equipment	161	294
Service credits and customer rebates	174	747
Interest payable	1,376	275
Other	3,974	4,915
Total accrued liabilities – other	$14,460	$ 15,487

15. 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 Internal Revenue Service (IRS) has initiated a review of our consolidated federal income tax return for the period ended December 31, 2009.

The total liability for uncertain tax positions that would affect our effective tax rate upon resolution of the uncertain tax position, which is recorded in our consolidated balance sheets in accrued liabilities – other, as of June 30, 2012 and December 31, 2011, was $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 June 30, 2012 and December 31, 2011, accrued interest and penalties related to tax positions taken on our tax returns are approximately $0.1 million.

The provision of $1.4 million for the three months ended June 30, 2012, includes $2.0 million of tax provision on the gain recorded in connection with the sale of a Chrome-branded asset, $0.2 million of a reduction in valuation allowance resulting from the gain on asset sale, and $0.4 million of benefit on the change in value of our warrant in TrueCar.

The provision of $12.8 million for the six months ended June 30, 2012, in addition to the items noted in the provision for the three months ended June 30, 2012, includes $10.4 million of tax provision on the gain recorded in connection with the contribution of the net assets of Chrome for the investment in Chrome Data Solutions, as well as $1.2 million of provision from the elimination of Chrome net deferred tax assets and goodwill.

16. 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.

Service Credit

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 and six months ended June 30, 2012, we recorded contra revenue related to the service credits of $0.1 million and $0.4 million, respectively. For the three and six months ended June 30, 2011, we recorded contra revenue related to the service credits of $0.3 million and $0.4 million, respectively. As of June 30, 2012, approximately $1.0 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 $6.1 million as of June 30, 2012, 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 $2.3 million as of June 30, 2012.

Lease Termination

In the first quarter of 2012, we attempted to exercise an early termination clause in a lease for one of our locations. The landlord refused to accept our early termination notice. The termination, if ultimately accepted by the landlord,

would result in our being required to pay an early termination fee of $1.3 million upon the early termination of the lease. No amounts have been recorded to the consolidated statement of operations for the six months ended June 30, 2012 as the termination has not been accepted.

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 has been remanded to the district court for further proceedings.

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

17. 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 and six months ended June 30, 2012 was approximately 11% and 10%, respectively, of our total net revenue. Revenue earned in Canada for the three and six months ended June 30, 2011 was approximately 10% of our total net revenue. Long-lived assets in Canada were $34.7 million and $35.5 million as of June 30, 2012 and December 31, 2011, respectively.

Supplemental disclosure of revenue by service type for the three and six months ended June 30, 2012 and 2011 is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Transaction services revenue	$ 57,433	$ 48,505	$ 111,512	$ 86,940
Subscription services revenue	33,932	34,716	67,163	68,581
Other	5,031	5,830	9,338	10,721
Total net revenue	$ 96,396	$ 89,051	$ 188,013	$ 166,242

18. 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 net proceeds from the offering were $178.8 million after deducting the initial purchaser's fees and offering expenses, as well as the cost of the hedge transactions and warrant proceeds.

The notes are senior unsecured obligations, subordinated in right of payment to existing and future secured senior indebtedness. The notes bear interest at a coupon rate of 1.50% per year, payable semi-annually in cash on March 15 and September 15 of each year, beginning on September 15, 2012. 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.

In the event of a fundamental change, including but not limited to delisting, liquidation, dissolution and other defined events, prior to maturity, the holders of the notes will have the ability to require us to repurchase all or any portion of their notes for cash at a repurchase price equal to 100% of the principal amount of the notes being repurchased plus any accrued and unpaid interest. If and only to the extent holders elect to convert the notes in connection with a make-whole fundamental change, there will be an increase in the conversion rate of a number of additional shares, which is based upon on the effective date of, and the price paid (or deemed paid) per share of our common stock in, such make-whole fundamental change. If holders of our common stock receive only cash in connection with certain make-whole fundamental changes, the price paid (or deemed paid) per share will be the cash amount paid per share. Otherwise, the price paid (or deemed paid) per share will be equal to the average of the closing sale prices of our common stock on the ten consecutive trading days prior to, but excluding, the effective date of such make-whole fundamental change.

Prior to October 15, 2016, the notes will be convertible only upon the occurrence of certain events and during certain periods, and thereafter, at any time until the second scheduled trading day immediately preceding the maturity date. Upon conversion, holders will receive, at our discretion, cash, shares of our common stock or a combination thereof. The initial conversion rate will be 26.7618 shares of our common stock (subject to customary adjustments) per $1,000 principal amount of notes, which is equivalent to an initial conversion price of approximately $37.37 per share of our common stock, which represents a conversion premium of approximately 33.50% to the closing sale price of $27.99 per share of our common stock on February 28, 2012. In addition, following certain corporate transactions that occur prior to the maturity date, in certain circumstances, we will increase the conversion rate for a holder that elects to convert its notes in connection with such a corporate transaction.

A holder of the notes may convert the notes under the following circumstances: (i) prior to October 15, 2016, on any date during any calendar quarter beginning after June 30, 2012 (and only during such calendar quarter) if the closing sale price of our common stock was more than 130% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous calendar quarter; (ii) prior to October 15, 2016, if we distribute rights, options or warrants to all or substantially all holders of our common stock entitling them to purchase, for a period of 45 calendar days or less from the declaration date for such distribution, shares of our common stock at a price per share less than the average closing sale price of our common stock for the ten consecutive trading days immediately preceding, but excluding, the declaration date for such distribution; (iii) prior to October 15, 2016, if we distribute to all or substantially all holders of our common stock cash, other assets, securities or rights to purchase our securities (other than upon implementation of a rights plan) which distribution has a per share value exceeding 10% of the closing sale price of our common stock on the trading day immediately preceding the declaration date for such distribution, or if we engage in certain corporate transactions as described in the indenture for the notes; (iv) prior to October 15, 2016, during the five consecutive business-day period following any ten consecutive trading-day period in which the trading price per $1,000 principal amount of notes for each trading day during such ten trading-day period was less than 98% of the closing sale price of our common stock for each trading day during such ten trading-day period multiplied by the then current conversion rate; or (v) on or after October 15, 2016, and on or prior to the second scheduled trading day immediately preceding the maturity date, without regard to the foregoing conditions.

In accordance with accounting guidance for debt with conversion and other options, we separately accounted for the liability and equity components of the notes. The estimated fair value of the liability component at the date of issuance was $156.1 million, and was computed based on the fair value of similar debt instruments that did not include a conversion feature. The equity component of $43.9 million was recognized as a debt discount and recorded as additional paid-in capital. The debt discount represents the difference between the $200.0 million principal amount of the notes and the $156.1 million estimated fair value of the liability component at the date of issuance. The debt discount will be amortized over the expected life of a similar liability without the equity component. We determined this expected life to be equal to the term of the notes, resulting in an amortization period for 5 years, ending March 15, 2017. The effective interest rate used to amortize the debt discount is approximately 6.75%, which was based on our estimated non-convertible borrowing rate of a similar liability without an equity component as of the date the notes were issued.

As of June 30, 2012, the "if-converted value" did not exceed the principal amount of the notes since the closing sales price of our common stock was less than the initial conversion price of the notes.

Issuance costs of $7.0 million related to the issuance of the notes were allocated to the liability and equity components in proportion to the allocation of the proceeds and accounted for as capitalized debt issuance costs and equity issuance costs, respectively. The amount allocated to capitalized debt issuance costs was $5.4 million. As of June 30, 2012, total capitalized debt issuance costs remaining to be amortized to interest expense were $5.1 million.

The net carrying amount of the liability component of the notes as of June 30, 2012 consists of the following (in thousands):

Principal amount	$200,000
Unamortized discount	41,544
Net carrying value	$158,456

Total interest expense associated with the notes consisted of the following for the three and six months ended June 30, 2012 (in thousands):

	Three months ended June 30, 2012	Six months ended June 30, 2012
Cash interest expense (1.50% coupon rate)	$ 750	$ 958
Amortization of debt issuance costs and debt discount	2,107	2,693
Total interest expense	$ 2,857	$ 3,651

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 hedge counterparties). The convertible note hedge transactions will cover, subject to customary anti-dilution adjustments, the number of shares of our common stock that will initially underlie the notes and are intended to reduce the potential dilutive impact of the conversion feature of the notes. We have also entered into separate privately negotiated warrant transactions with the hedge counterparties.

The convertible note hedge will terminate upon the earlier of the maturity date of the notes or the first day the notes are no longer outstanding. We paid $43.9 million for the convertible note hedges, which were recorded as a reduction to additional paid-in capital.

The warrant transactions have an initial strike price of approximately $46.18 per share, and may be settled in cash or shares of our common stock, at our option. The warrant transactions will have a dilutive effect to the extent that the market price per share of our common stock exceeds the applicable strike price of the warrants. Proceeds received from the warrant transactions totaled $29.7 million and were recorded as additional paid-in capital. The warrants expire at various dates during 2017.

The convertible note hedge and warrants are both considered indexed to our common stock and classified as equity; therefore, the convertible note hedge and warrants are not accounted for as derivative instruments.

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. Additional dilution will occur if our stock price exceeds the warrant strike price of $46.18.

19. Revolving Credit Facility

On April 20, 2011, we entered into a $125.0 million revolving credit facility (including a $25.0 million Canadian sublimit), which is available for general corporate purposes (including capital expenditures and investments), subject to certain conditions. The agreement for this revolving credit facility also permits us, under certain conditions, to obtain up to an additional $100.0 million of incremental term loans or incremental revolving commitments from existing or new lenders. 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.

On February 27, 2012, we entered into a first amendment to the credit agreement, which, among other things: (i) permits us to make mandatory interest and principal payments and settle conversions in respect of the senior convertible notes in cash, shares of our common stock, or a combination thereof; and (ii) permits us to enter into the hedge transactions and warrants in connection with the private offering of the notes (as described above).

On February 29, 2012, we entered into a second amendment to the amended credit agreement, which, among other things: (i) reduces the commitment fee payable under and the interest rate margins applicable to extensions of credit

pursuant to the amended credit agreement; (ii) extends the termination date of the revolving commitments under the amended credit agreement to March 1, 2017; (iii) increases to $200.0 million the maximum aggregate incremental term loans and revolving commitments that may be made available to us under the amended credit agreement; and (iv) revises the financial maintenance covenants in the amended credit agreement to increase the maximum leverage ratio and decrease the minimum interest coverage ratio, and to add a maximum secured leverage ratio.

The interest rate on the amended credit facility is determined quarterly and is equal to LIBOR or Prime, as applicable, plus a margin of (a) between 150 basis points and 225 basis points in the case of Eurodollar/CDOR loans and (b) between 50 basis points and 125 basis points in the case of ABR loans. The rate, in each case, is based on a consolidated leverage ratio for us and our restricted subsidiaries (the ratio of consolidated total debt of us and our restricted subsidiaries to consolidated EBITDA of us and our restricted subsidiaries). Additionally, under the credit facility we are required to make quarterly commitment fee payments on any available unused revolving amounts at a rate between 25 basis points and 40 basis points based on our consolidated leverage ratio.

We have capitalized approximately $2.7 million of total debt issuance costs associated with the credit facility, of which $2.1 million was remaining to be amortized as interest expense as of June 30, 2012. Debt issuance costs associated with the credit facility amortized to interest expense for the three and six months ended June 30, 2012 were $0.1 million and $0.2 million, respectively. Interest expense related to the commitment fee for the three and six months ended June 30, 2012 was $0.1 million and $0.2 million, respectively. As of June 30, 2012, we had no amounts outstanding under our credit facility and were in compliance with all restrictive covenants and financial ratios.

20. Subsequent Events

On July 15, 2012, DealerTrack, Inc. entered into a Stock Purchase Agreement that provides for the purchase of all issued and outstanding shares of capital stock of 1st Auto Transport Directory, Inc. (1st Auto Transport), a Delaware corporation. The consideration, which consists of $74.0 million in cash, is subject to working capital adjustments subsequent to closing. The actual closing occurred on August 1, 2012. We are planning to utilize a 338(h)(10) election for tax purposes in connection with the transaction with anticipated future tax savings over several years with a present value of approximately $12.0 million.

Founded in 1997, San Diego-based 1st Auto Transport delivers a comprehensive suite of vehicle transportation related solutions for auto dealers, brokers, shippers, and carriers within the U.S. and Canadian automotive retail markets. 1st Auto Transport’s offerings include:

- CentralDispatch.com, a leading business-to-business, subscription-based network for facilitating vehicle transportation, with more than 13,000 network subscribers, of which over 4,500 are automotive dealers;
- jTracker.com, a CRM and lead management tool for automotive transportation brokers; and
- MoveCars.com, one of the premier online advertising directories for the vehicle transportation industry.

We expensed approximately $0.2 million of professional fees associated with the acquisition in the three and six months ended June 30, 2012. We expect to expense an additional approximately $0.2 million of professional fees in the third quarter of 2012.

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 third quarter of 2012. Based upon preliminary results, we expect to recognize approximately $26 million of intangibles and $46 million of goodwill as part of the allocation of purchase price. Both the acquired goodwill and intangible assets are deductible for tax purposes.

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 include those discussed in "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, 2011 filed with the SEC on February 22, 2012. 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. DealerTrack's dealer management system (DMS) solution provides dealers with easy-to-use tools and real-time data access to enhance their efficiency. DealerTrack's Inventory solutions offerings provide vehicle inventory management, merchandising, and transportation solutions to help dealers drive higher in-store and online traffic with real-time listings designed to accelerate used-vehicle turn rates and increase dealer profits. DealerTrack's Sales and Finance solutions allow dealers to streamline the entire sales process as they structure deals from a single integrated platform. Our Compliance offering helps dealers meet legal and regulatory requirements, and protect their assets. DealerTrack also offers Processing solutions for the automotive industry, including digital retailing, electronic motor vehicle registration and titling applications, paper title storage, and digital document services.

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 subscribing dealers in the DealerTrack network, the number of transactions processed, the average transaction price, the average monthly subscription revenue per subscribing dealership and transaction revenue per car sold. We believe that improvements in these metrics will result in improvements in our financial performance over time.

The following is a table consisting of non-GAAP financial measures and certain other business statistics that management is continually monitoring (amounts in thousands are GAAP net income, adjusted EBITDA, adjusted net income, capital expenditures and transactions processed):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
GAAP net income:	5,925	2,166	22,886	26,894
Non-GAAP Financial Measures and Other Business Statistics:				
Adjusted EBITDA – previous presentation (non-GAAP) (1)	$ 21,655	$ 21,270	$ 37,744	$ 33,948
Adjusted EBITDA (non-GAAP) (1)	$ 25,037	$ 24,305	$ 44,456	$ 39,798
Adjusted net income (non-GAAP) (1)	$ 13,714	$ 10,835	$ 23,158	$ 18,325
Capital expenditures, software and website development costs	$ 7,688	$ 6,117	$ 15,652	$ 16,333
Active dealers in our U.S. network as of end of the period (2)	18,638	17,660	18,638	17,660
Active lenders in our U.S. network as of end of the period (3)	1,212	1,062	1,212	1,062
Active lender to dealer relationships as of end of the period (4)	177,570	157,591	177,570	157,591
Subscribing dealers in our U.S. and Canadian networks as of end of the period (5)	16,280	14,488	16,280	14,488
Transactions processed (6)	22,562	19,135	44,313	35,909
Average transaction price (7)	$ 2.59	$ 2.58	$ 2.56	$ 2.47
Average monthly subscription revenue per subscribing dealership (8)	$ 697	$ 807	$ 693	$ 802
Transaction revenue per car sold (9)	$ 6.12	$ 5.73	$ 7.12	$ 6.13

(1) Adjusted EBITDA is a non-GAAP financial measure that represents GAAP net income excluding interest, taxes, depreciation and amortization expenses, stock-based compensation, contra-revenue and may exclude certain items 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 or losses on sales of securities, gains or losses on sales or disposals of subsidiaries and other assets, and certain other non-recurring items.

In response to requests, and in consideration of comparable peer companies, stock-based compensation expense is now excluded from the calculation of the Adjusted EBITDA non-GAAP measure. This reduces the comparability with prior periods. This non-cash expense was included in presentations prior to the fourth quarter of 2011 and is captioned above as “Adjusted EBITDA – previous presentation (non-GAAP).”

Adjusted net income is a non-GAAP financial measure that represents GAAP net income excluding stock-based compensation expense, the amortization of acquired identifiable intangibles, contra-revenue, and may also exclude certain items 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 or losses on sales of securities, gains or losses on sales or disposals of subsidiaries and other assets, adjustments to deferred tax asset valuation allowances, non-cash interest expense and certain other non-recurring items. These adjustments to net 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 an analytical tool 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 income, our most directly comparable financial measure in accordance with GAAP (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
GAAP net income	$ 5,925	$ 2,166	$ 22,886	$ 26,894
Interest income	(184)	(84)	(414)	(198)
Interest expense – cash	988	212	1,442	244
Interest expense – non-cash (10)	2,220	—	2,923	—
Provision for (benefit from) income taxes, net	1,443	4,085	12,832	(21,628)
Depreciation of property and equipment and amortization of capitalized software and website costs	6,295	5,286	11,395	10,171
Amortization of acquired identifiable intangibles	6,653	7,708	13,532	14,568
EBITDA (non-GAAP)	23,340	19,373	64,596	30,051
Adjustments:				
Gain on disposal of subsidiary and sale of other assets	(5,500)	—	(33,193)	—
Acquisition-related and other professional fees	538	886	737	1,216
Contra-revenue (11)	996	1,114	2,098	2,057
Integration and other related costs (including amounts related to stock-based compensation)	221	306	221	958
Acquisition-related contingent consideration changes and compensation expense, net (12)	(220)	—	(42)	75
Amortization of equity method investment basis difference (13)	996	—	1,993	—
Rebranding expense	284	—	334	—
Change in fair value of warrant	1,000	—	1,000	—
Realized gain on securities	—	(409)	—	(409)
Adjusted EBITDA – previous presentation (non-GAAP)	21,655	21,270	37,744	33,948
Stock-based compensation (excluding amounts included in integration and other related costs)	3,382	3,035	6,712	5,850
Adjusted EBITDA (non-GAAP)	$ 25,037	$ 24,305	$ 44,456	$ 39,798

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
GAAP net income	$ 5,925	$ 2,166	$ 22,886	$ 26,894

Adjustments:				
Deferred tax asset valuation allowance (non-taxable) (14)	—	1,001	—	(23,547)
Amortization of acquired identifiable intangibles	6,653	7,708	13,532	14,568
Stock-based compensation (excluding integration and other related costs)	3,382	3,035	6,712	5,850
Gain on disposal of subsidiary and sale of other assets	(5,500)	—	(33,193)	—
Contra-revenue (11)	996	1,114	2,098	2,057
Integration and other related costs (including amounts related to stock-based compensation)	221	306	221	958
Interest expense – non-cash (not tax-impacted) (10)	2,220	—	2,923	—
Amortization of equity method investment basis difference (13)	996	—	1,993	—
Acquisition-related and other professional fees	538	886	737	1,216
Acquisition-related contingent consideration changes and compensation expense, net (12)	(220)	—	(42)	75
Rebranding expense	284	—	334	—
Realized gain on securities (non-taxable)	—	(409)	—	(409)
Accelerated depreciation of certain technology assets (15)	929	—	929	—
Change in fair value of warrant	1,000	—	1,000	—
Amended state tax returns impact (non-taxable)	—	—	—	32
Tax impact of adjustments (16)	(3,710)	(4,972)	3,028	(9,369)
Adjusted net income (non-GAAP)	$ 13,714	$ 10,835	$ 23,158	$ 18,325

(2) We consider a dealer to be active in our U.S. network as of a date if the dealer completed at least one revenue-generating credit application processing transaction using the U.S. DealerTrack network during the most recently ended calendar month. The number of active U.S. dealers is based on the number of dealer accounts as communicated by lenders on the U.S. DealerTrack network.

(3) We consider a lender to be active in our U.S. network as of a date if it is accepting credit application data electronically from U.S. dealers in the U.S. DealerTrack network.

(4) Each lender to dealer relationship represents a pair between an active U.S. lender and an active U.S. dealer at the end of a given period.

(5) Represents the number of dealerships with one or more active subscriptions on the U.S. DealerTrack or DealerTrack Canada networks at the end of a given period.

(6) Represents revenue-generating transactions processed in the U.S. DealerTrack, DealerTrack Aftermarket Services, DealerTrack Processing Solutions and DealerTrack Canada networks at the end of a given period.

(7) Represents the average revenue earned per transaction processed in the U.S. DealerTrack, DealerTrack Aftermarket Services, DealerTrack Processing Solutions and DealerTrack Canada networks during a given period. Revenue used in the calculation adds back (excludes) transaction related contra-revenue.

(8) Represents subscription services revenue divided by average subscribing dealers for a given period in the U.S. DealerTrack and DealerTrack Canada networks. Revenue used in the calculation adds back (excludes) subscription related contra-revenue.

(9) Represents transaction revenue divided by our estimate of total new and used car sales for the period in the U.S. and Canada. Revenue used in this calculation adds back (excludes) transaction related contra-revenue.

(10) Represents interest expense relating to the amortization of deferred financing costs and debt discount.

(11) For further information, please refer to Note 16 in the accompanying notes to the consolidated financial statements included in this Quarterly Report on Form 10-Q and Note 16 in the notes to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011.

(12) Represents the change in the acquisition-related contingent consideration from the eCarList acquisition and other additional acquisition related compensation charges.

(13) Represents amortization of the basis difference between the book basis of contributed Chrome assets and the fair value of the investment in Chrome Data Solutions.

(14) As a result of the acquisition of DealerTrack Processing Solutions, on January 31, 2011, we evaluated the combined enterprises past and expected future results, including the impact of the future reversal of the acquired deferred tax liabilities, and determined that the future reversal of the acquired deferred tax liabilities would provide sufficient taxable income to support realization of certain of DealerTrack's deferred tax assets and thereby we reduced the valuation allowance by approximately $24.5 million during the three months ended March 31, 2011.

(15) Represents the accelerated depreciation of certain technology assets due to the discontinuation of those projects.

(16) The tax impact of adjustments for the three and six months ended June 30, 2012 are based on a U.S. statutory tax rate of 37.4% applied to taxable adjustments other than amortization of acquired identifiable intangibles and stock-based compensation expense, which are based on a blended tax rate of 37.3% and 36.8%, respectively, for the three months ended June 30, 2012, and 37.3% and 36.9%, respectively, for the six months ended June 30, 2012. The tax impact of adjustments for the three and six months ended June 30, 2011 are based on a U.S. statutory tax rate of 38.3% applied to taxable adjustments other than amortization of acquired identifiable intangibles and stock-based compensation expense, which are based on a blended tax rate of 38.2% and 37.9%, respectively, for the three months ended June 30, 2011, and 37.9% and 37.9%, respectively, for the six months ended June 30, 2011.

Revenue

Transaction Services Revenue. Transaction services revenue consists of revenue earned from our lender customers for each credit application or contract that dealers submit to them. In addition, we earn transaction services revenue from lender customers for each financing contract executed via our electronic contracting and digital contract processing solutions, as well as for any ALG portfolio residual value analyses performed prior to disposal. In addition, we earn transaction service revenue from lender customers for collateral management transactions.

We also earn transaction services revenue from dealers or other service and information providers, such as aftermarket providers, accessory providers and credit report providers, for each fee-bearing product accessed by dealers. This includes transaction revenue for completion of on-line registrations with department of motor vehicles, completion of inventory appraisals, and accessing of credit reports.

Subscription Services Revenue. Subscription services revenue consists of revenue earned from our dealers and other customers (typically on a monthly basis) for use of our subscription or license-based products and services. Our subscription services enable dealer customers to manage their dealership data and operations, compare various financing and leasing options and programs, sell insurance and other aftermarket products, analyze and merchandise inventory and execute financing contracts electronically.

Other Revenue. Other revenue consists of revenue primarily earned through forms programming, data conversion, training and hardware and equipment sales from our dealer management system (DMS) solution, shipping fees and commissions earned from our digital contract business, consulting and analytical revenue earned from ALG in periods prior to disposal, and training fees earned from our inventory management solution. Other revenue is recognized when the service is rendered.

Operating Expenses

Cost of Revenue. Cost of revenue primarily consists of expenses related to running our network infrastructure (including Internet connectivity, hosting expenses, and data storage), amortization expense on acquired intangible assets, capitalized software and website development costs, compensation and related benefits for network and technology development personnel, amounts paid to third parties pursuant to contracts under which (i) a portion of certain revenue is owed to those third parties (revenue share) or, (ii) fees are due on the number of transactions processed, direct costs for data licenses and direct costs (printing, binding and delivery) associated with our residual value guides from ALG in periods prior to disposal. Cost of revenue also includes hardware costs associated with our DMS product offering, and compensation, related benefits and travel expenses associated with DMS installation personnel, compensation and related benefits associated with strategic inventory consulting personnel, compensation and related benefits, and temporary labor associated with personnel who process transactions for our digital contract, collateral management, and registration and titling solutions, and advertising expenses associated with our search and media product offerings.

Product Development *Expenses.* Product development expenses consist primarily of compensation and related benefits, consulting fees and other operating expenses associated with our product development departments. The product development departments perform research and development, in addition to enhancing and maintaining existing products.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of compensation and related benefits, facility costs and professional services fees for our sales, marketing, customer service and administrative functions.

We allocate overhead such as occupancy and telecommunications charges, and depreciation expense based on headcount, as we believe this to be the most accurate measure. As a result, a portion of general overhead expenses is reflected in cost of revenue and each other operating expense category.

Acquisitions

On August 1, 2012, DealerTrack, Inc. purchased all issued and outstanding shares of capital stock of 1st Auto Transport Directory, Inc., a Delaware corporation. The consideration, which consists of $74.0 million in cash, is subject to working capital adjustments subsequent to closing.

Founded in 1997, San Diego-based 1st Auto Transport delivers a comprehensive suite of vehicle transportation related solutions for auto dealers, brokers, shippers, and carriers within the U.S. and Canadian automotive retail markets. The company's offerings include CentralDispatch.com, jTracker.com and MoveCars.com.

Fair Value Measurements

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.

A reconciliation of the beginning and ending balances for the warrant, a Level 3 investment, is as follows (in thousands):

Balance as of December 31, 2011	$6,500
Change in fair value of warrant	(1,000)
Balance as of June 30, 2012	$5,500

In connection with our October 1, 2011 disposal of ALG, we acquired a warrant to purchase 6.3 million additional shares of TrueCar common stock and recorded the warrant as a long-term investment. As a result of a net settlement feature, the warrant is revalued each reporting period through its expiration date of October 1, 2012, with the change in fair value recorded in the consolidated statements of operations. The fair value of the warrant is estimated using a Black-Scholes option pricing model. The significant unobservable inputs used in the pricing model are share price, expected volatility, and expected term. An increase (decrease) in any of these individual inputs would result in a significantly higher (lower) estimated fair value measurement. For the three months ended June 30, 2012, the value decreased by $1.0 million due to a decrease in the remaining expected term.

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

Balance as of December 31, 2011	$(900)
Change in fair value of contingent consideration	900
Balance as of June 30, 2012	$—

A portion of the purchase price of eCarList included contingent consideration that is payable in the first quarter of 2013 based upon the achievement of certain revenue targets in 2012. 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. As of June 30, 2012, we do not expect to make any contingent consideration payments for the achievement of revenue targets in 2012. We recorded income of $0.7 million and $0.9 million for the three and six months ended June 30, 2012, respectively, as a result of the decrease in the estimated settlement of the contingent consideration from the estimated amount as of December 31, 2011.

Critical Accounting Policies and Estimates

Our management's discussion and analysis of our financial condition and results of our operations is based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the amounts reported for assets, liabilities, revenue, expenses and the disclosure of contingent liabilities.

Our critical accounting policies are those that we believe are both important to the portrayal of our financial condition and results of operations and that involve difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The estimates are based on historical experience and on various assumptions about the ultimate outcome of future events. Our actual results may differ from these estimates if unforeseen events occur or should the assumptions used in the estimation process differ from actual results. Management believes there have been no material changes to the critical accounting policies discussed in the section entitled "Management Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2011, except as set forth below.

Transaction Revenue

Collateral Management Services Transaction Revenue

Our collateral management solution provides vehicle title and administration services for our customers, which are comprised mainly of lenders, financial institutions, and credit unions. The solution facilitates communication between our customers and the state department of motor vehicles by providing a solution for our customers to monitor title perfection and expedite the processing of liens with the state department of motor vehicles. We offer both paper-based and electronic-based title services depending on state requirements. Customer contracts for title services are principally comprised of two elements: (1) title perfection confirmation and (2) title administration.

For paper-based titles, title perfection confirmation occurs upon the receipt of title and lien documentation supporting title perfection from the department of motor vehicles. For electronic-based titles, title perfection confirmation is achieved upon electronic acknowledgement that department of motor vehicles' records reflect the customer as the lien holder.

For paper-based titles, title administration services require us to physically hold, store and manually release the title. For electronic-based titles, title administration services require data storage. The release of the electronic 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) relative selling price is determined.

Based on the above criteria, paper and electronic-based collateral management service revenue are separated into two units of accounting. We recognize a portion of the paper-based transaction fee upon receipt of title and lien documentation supporting title perfection from the department of motor vehicles. For electronic-based titles, we recognize a portion of the fee upon electronic acknowledgement that the department of motor vehicles' records reflect the customer as the lien holder. For paper-based title services, amounts allocated to each unit of accounting are based upon vendor-specific objective evidence. For electronic-based title services, amounts allocated to each unit of accounting are based upon estimated selling price, which is based upon an adjustment to the selling price of our individual paper-based title services, when sold separately. The adjustment to the selling price is due to the lower selling price of electronic-based services compared to paper-based services.

For customers in which we bill the entire transaction fee in advance, the title administration portion of the fee for both paper and electronic-based titles is deferred and recognized over the title administration period, which is estimated at 39 months. This estimate is based upon a historical analysis of the average time period between the date of financing and the date of pay-off.

Collateral management services revenue also includes revenue earned from converting a new lender's title portfolio to our collateral management solution, which may include 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.

Marketable Securities

Marketable securities consist of U.S. treasury and agency securities, corporate bonds, municipal bonds and a tax-advantaged preferred security. All of our marketable securities are classified as available-for-sale securities and are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of accumulated other comprehensive income until realized.

Senior Convertible Notes

In accordance with FASB ASC Topic 470-20, *Debt with Conversion and Other Options* (ASC 470-20), we separately account for the liability and equity components of our senior convertible notes. The estimated fair value of the liability component is computed based on an assessment of the fair value of a similar debt instrument that does not include a conversion feature. The equity component, which is recognized as a debt discount and recorded in additional paid-in capital, represents the difference between the gross proceeds from the issuance of the notes and the estimated fair value of the liability component at the date of issuance. The debt discount is amortized over the expected life of a similar liability without the equity component. The effective interest rate used to amortize the debt discount is based on our estimated non-convertible borrowing rate of a similar liability without an equity component as of the date the notes were issued.

Equity Method Accounting

We apply the equity method of accounting to investments in entities in which we own more than 20% of the equity of the entity and exercise significant influence.

Stock-Based Compensation Expense and Assumptions

Expected Stock Price Volatility

As of January 1, 2012, we determine the expected volatility of any stock-based awards we issue based on our historical volatility. Previously, due to our limited public company history, the expected volatility for stock-based awards was determined using a time-weighted average of our historical volatility and the expected volatility of similar entities whose common shares are publicly-traded. In recent years, our historical volatility did not vary significantly

from the expected volatility of similar entities. As such, we do not expect this change to have a significant impact on future operating results.

Results of Operations

The following table sets forth, for the periods indicated, the consolidated statements of operations:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012		2011		2012		2011	
	$ Amount	% of Net Revenue	$ Amount	% of Net Revenue	$ Amount	% of Net Revenue	$ Amount	% of Net Revenue
	(In thousands, except percentages)				(In thousands, except percentages)			
Consolidated Statements of Operations Data:								
Net revenue	$96,396	100.0 %	$89,051	100.0 %	$188,013	100.0 %	$166,242	100.0 %
Operating expenses:								
Cost of revenue	53,712	55.7	48,565	54.6	106,862	56.8	92,992	55.9
Product development	2,944	3.1	3,118	3.5	5,938	3.2	6,471	3.9
Selling, general and administrative	34,067	35.3	31,490	35.4	68,195	36.3	61,975	37.3
Total operating expenses	90,723	94.1	83,173	93.5	180,995	96.3	161,438	97.1
Income from operations	5,673	5.9	5,878	6.5	7,018	3.7	4,804	2.9
Interest income	184	0.2	84	0.1	414	0.2	198	0.1
Interest expense	(3,208)	(3.3)	(212)	(0.2)	(4,365)	(2.3)	(244)	(0.1)
Other income (expense), net	(926)	(1.0)	92	0.1	(850)	(0.4)	99	0.1
Gain on disposal of subsidiary and sale of other assets	5,500	5.7	—	—	33,193	17.7	—	—
Earnings from equity method investment, net	145	0.1	—	—	308	0.1	—	—
Realized gain on securities	—	—	409	0.5	—	—	409	0.2
Income before (provision for) benefit from income taxes	7,368	7.6	6,251	7.0				