

DealerTrack Holdings, Inc.  
Form 10-Q  
August 11, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2008

**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**  
(State or other jurisdiction of incorporation or  
organization)

**52-2336218**  
(I.R.S. Employer Identification Number)

**1111 Marcus Ave., Suite M04**  
**Lake Success, NY**  
(Address of principal executive offices)

**11042**  
(Zip Code)

Registrant's telephone number, including area code: **(516) 734-3600**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

As of July 31, 2008, 40,737,414 shares of the registrant's common stock were outstanding.

**DEALERTRACK HOLDINGS, INC.**  
**FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008**  
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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**DEALERTRACK HOLDINGS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(unaudited)**

|                                                                                                                    | <b>June 30,</b>                    | <b>December</b> |
|--------------------------------------------------------------------------------------------------------------------|------------------------------------|-----------------|
|                                                                                                                    | <b>2008</b>                        | <b>31,</b>      |
|                                                                                                                    | <b>2007</b>                        |                 |
|                                                                                                                    | <b>(In thousands, except share</b> |                 |
|                                                                                                                    | <b>and per share amounts)</b>      |                 |
| <b>ASSETS</b>                                                                                                      |                                    |                 |
| Current assets                                                                                                     |                                    |                 |
| Cash and cash equivalents                                                                                          | \$ 168,038                         | \$ 50,564       |
| Short-term investments                                                                                             | 35,345                             | 169,580         |
| Accounts receivable, net of allowances of \$3,529 and \$2,615 at June 30, 2008 and December 31, 2007, respectively | 27,533                             | 26,957          |
| Prepaid expenses and other current assets                                                                          | 9,135                              | 7,305           |
| Deferred tax assets                                                                                                | 3,475                              | 3,827           |
| <br>                                                                                                               |                                    |                 |
| Total current assets                                                                                               | 243,526                            | 258,233         |
| Long-term investments                                                                                              | 12,842                             |                 |
| Property and equipment, net                                                                                        | 13,329                             | 12,792          |
| Software and web site developments costs, net                                                                      | 12,010                             | 10,771          |
| Intangible assets, net                                                                                             | 55,971                             | 69,528          |
| Goodwill                                                                                                           | 116,098                            | 117,702         |
| Restricted cash                                                                                                    | 540                                | 540             |
| Deferred taxes and other long-term assets                                                                          | 15,745                             | 13,360          |
| <br>                                                                                                               |                                    |                 |
| Total assets                                                                                                       | \$ 470,061                         | \$ 482,926      |
| <br>                                                                                                               |                                    |                 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                                                                         |                                    |                 |
| Current liabilities                                                                                                |                                    |                 |
| Accounts payable                                                                                                   | \$ 2,223                           | \$ 4,762        |
| Accrued compensation and benefits                                                                                  | 7,628                              | 12,527          |
| Accrued other                                                                                                      | 11,532                             | 11,387          |
| Deferred revenue                                                                                                   | 5,503                              | 4,016           |
| Due to acquirees                                                                                                   | 1,735                              | 2,251           |
| Capital leases payable                                                                                             | 372                                | 480             |
| <br>                                                                                                               |                                    |                 |
| Total current liabilities                                                                                          | 28,993                             | 35,423          |
| <br>                                                                                                               |                                    |                 |
| Capital leases payable long-term                                                                                   | 630                                | 1,076           |
| Due to acquirees long-term                                                                                         | 600                                | 1,280           |

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|                                                                                                                                                                                                                                                                |            |            |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| Deferred tax liabilities – long-term                                                                                                                                                                                                                           | 3,172      | 2,800      |
| Deferred revenue and other long-term liabilities                                                                                                                                                                                                               | 4,886      | 3,985      |
| <br>                                                                                                                                                                                                                                                           |            |            |
| Total liabilities                                                                                                                                                                                                                                              | 38,281     | 44,564     |
| <br>                                                                                                                                                                                                                                                           |            |            |
| Commitments and contingencies (Note 16)                                                                                                                                                                                                                        |            |            |
| Stockholders' equity                                                                                                                                                                                                                                           |            |            |
| Preferred stock, \$0.01 par value: 10,000,000 shares authorized and no shares issued and outstanding at June 30, 2008 and December 31, 2007                                                                                                                    |            |            |
| Common stock, \$0.01 par value: 175,000,000 shares authorized; 42,743,375 shares issued and 41,742,650 shares outstanding at June 30, 2008; and 175,000,000 shares authorized; 42,556,925 shares issued and 42,552,723 shares outstanding at December 31, 2007 | 427        | 426        |
| Treasury stock, at cost, 1,000,725 shares and 4,202 shares at June 30, 2008 and December 31, 2007, respectively                                                                                                                                                | (19,270)   | (139)      |
| Additional paid-in capital                                                                                                                                                                                                                                     | 421,722    | 413,428    |
| Deferred stock-based compensation (APB 25)                                                                                                                                                                                                                     | (1,232)    | (2,056)    |
| Accumulated other comprehensive income                                                                                                                                                                                                                         | 6,207      | 8,181      |
| Retained earnings                                                                                                                                                                                                                                              | 23,926     | 18,522     |
| <br>                                                                                                                                                                                                                                                           |            |            |
| Total stockholders' equity                                                                                                                                                                                                                                     | 431,780    | 438,362    |
| <br>                                                                                                                                                                                                                                                           |            |            |
| Total liabilities and stockholders' equity                                                                                                                                                                                                                     | \$ 470,061 | \$ 482,926 |

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

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

|                                                       | <b>Three Months Ended June</b>                            |              | <b>Six Months Ended June 30,</b>                          |               |
|-------------------------------------------------------|-----------------------------------------------------------|--------------|-----------------------------------------------------------|---------------|
|                                                       | <b>2008</b>                                               | <b>2007</b>  | <b>2008</b>                                               | <b>2007</b>   |
|                                                       | <b>(In thousands, except share and per share amounts)</b> |              | <b>(In thousands, except share and per share amounts)</b> |               |
| <b>Revenue</b>                                        |                                                           |              |                                                           |               |
| Net revenue                                           | \$ 63,181                                                 | \$ 58,507    | \$ 127,489                                                | \$ 110,232    |
| <b>Operating costs and expenses</b>                   |                                                           |              |                                                           |               |
| Cost of revenue(1)                                    | 27,879                                                    | 24,158       | 56,491                                                    | 45,458        |
| Product development(1)                                | 3,084                                                     | 2,281        | 6,226                                                     | 4,661         |
| Selling, general and administrative(1)                | 28,010                                                    | 22,313       | 57,742                                                    | 43,561        |
| <br>Total operating costs and expenses                | <br>58,973                                                | <br>48,752   | <br>120,459                                               | <br>93,680    |
| <br>Income from operations                            | <br>4,208                                                 | <br>9,755    | <br>7,030                                                 | <br>16,552    |
| Interest income                                       | 1,145                                                     | 1,220        | 2,708                                                     | 2,751         |
| Interest expense                                      | (74)                                                      | (73)         | (166)                                                     | (135)         |
| <br>Income before provision for income taxes          | <br>5,279                                                 | <br>10,902   | <br>9,572                                                 | <br>19,168    |
| Provision for income taxes, net                       | (2,213)                                                   | (4,618)      | (4,168)                                                   | (8,059)       |
| <br>Net income                                        | <br>\$ 3,066                                              | <br>\$ 6,284 | <br>\$ 5,404                                              | <br>\$ 11,109 |
| <br>Basic net income per share                        | <br>\$ 0.07                                               | <br>\$ 0.16  | <br>\$ 0.13                                               | <br>\$ 0.29   |
| Diluted net income per share                          | \$ 0.07                                                   | \$ 0.15      | \$ 0.13                                                   | \$ 0.27       |
| Weighted average shares outstanding                   | 41,505,503                                                | 38,748,405   | 41,569,468                                                | 38,685,500    |
| Weighted average shares outstanding assuming dilution | 42,764,086                                                | 40,569,993   | 42,863,406                                                | 40,437,270    |

(1) Stock-based compensation expense recorded for the three and six months ended June 30, 2008 and 2007 was

classified as  
follows:

|                                     | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|-------------------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                                     | <b>2008</b>                        | <b>2007</b> | <b>2008</b>                      | <b>2007</b> |
| Cost of revenue                     | \$ 599                             | \$ 476      | \$ 1,213                         | \$ 890      |
| Product development                 | 181                                | 153         | 358                              | 289         |
| Selling, general and administrative | 2,754                              | 1,817       | 5,424                            | 3,396       |

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

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

|                                                                                  | <b>Six Months Ended June 30,</b> |             |
|----------------------------------------------------------------------------------|----------------------------------|-------------|
|                                                                                  | <b>2008</b>                      | <b>2007</b> |
|                                                                                  | <b>(In thousands)</b>            |             |
| <b>Cash flows from operating activities</b>                                      |                                  |             |
| Net income                                                                       | \$ 5,404                         | \$ 11,109   |
| Adjustments to reconcile net income to net cash provided by operating activities |                                  |             |
| Depreciation and amortization                                                    | 20,208                           | 16,944      |
| Deferred tax benefit                                                             | (1,135)                          | (3,129)     |
| Amortization of deferred stock-based compensation                                | 6,995                            | 4,575       |
| Provision for doubtful accounts and sales credits                                | 3,572                            | 2,388       |
| Loss on sale of property and equipment                                           | 1                                | 17          |
| Amortization of bond premium                                                     | 18                               |             |
| Amortization of deferred interest                                                | 103                              | 87          |
| Deferred compensation                                                            | 125                              | 145         |
| Amortization of bank financing costs                                             | 31                               | 61          |
| Stock-based compensation windfall tax benefit                                    | (290)                            | (1,663)     |
| Changes in operating assets and liabilities, net of effects of acquisitions      |                                  |             |
| Trade accounts receivable                                                        | (4,248)                          | (8,174)     |
| Prepaid expenses and other current assets                                        | (1,844)                          | 1,086       |
| Accounts payable and accrued expenses                                            | (6,527)                          | (3,620)     |
| Deferred revenue and other current liabilities                                   | 1,499                            | 1,048       |
| Other long-term liabilities                                                      | 543                              | (259)       |
| Deferred rent                                                                    | 360                              | 94          |
| Other long-term assets                                                           | (519)                            | (171)       |
| <br>                                                                             |                                  |             |
| Net cash provided by operating activities                                        | 24,296                           | 20,538      |
| <br>                                                                             |                                  |             |
| <b>Cash flows from investing activities</b>                                      |                                  |             |
| Capital expenditures                                                             | (2,991)                          | (3,038)     |
| Purchase of investments                                                          | (144,084)                        | (227,850)   |
| Sale of investments                                                              | 264,912                          | 293,965     |
| Capitalized software and web site development costs                              | (4,410)                          | (2,053)     |
| Proceeds from sale of property and equipment                                     | 2                                | 7           |
| Payment for net assets acquired, net of acquired cash                            | (2,358)                          | (99,387)    |
| <br>                                                                             |                                  |             |
| Net cash provided by (used in) investing activities                              | 111,071                          | (38,356)    |
| <br>                                                                             |                                  |             |
| <b>Cash flows from financing activities</b>                                      |                                  |             |
| Principal payments on capital lease obligations                                  | (554)                            | (5)         |
| Proceeds from the exercise of employee stock options                             | 797                              | 1,552       |
| Proceeds from employee stock purchase plan                                       | 1,094                            | 823         |



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|                                                              |            |           |
|--------------------------------------------------------------|------------|-----------|
| Purchase of treasury stock                                   | (19,131)   | (54)      |
| Principal payments on notes payable                          |            | (211)     |
| Stock-based compensation windfall tax benefit                | 290        | 1,663     |
| Other                                                        |            | (1)       |
| Net cash (used in) provided by financing activities          | (17,504)   | 3,767     |
| Net increase (decrease) in cash and cash equivalents         | 117,863    | (14,051)  |
| Effect of exchange rate changes on cash and cash equivalents | (389)      | 570       |
| Cash, beginning of period                                    | 50,564     | 47,080    |
| Cash, end of period                                          | \$ 168,038 | \$ 33,599 |

**Supplemental disclosure**

Cash paid for:

|              |          |           |
|--------------|----------|-----------|
| Income taxes | \$ 4,846 | \$ 11,181 |
| Interest     | 84       | 48        |

Non-cash investing and financing activities:

|                                                         |     |     |
|---------------------------------------------------------|-----|-----|
| Accrued capitalized hardware, software and fixed assets | 505 | 609 |
| Goodwill adjustment                                     |     | 72  |
| Deferred compensation reversal to equity                | 125 | 211 |

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

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

**1. Business Description**

DealerTrack Holdings, Inc. is a leading provider of on-demand software, and data solutions for the automotive retail industry in the United States. Utilizing the Internet, we have built a network connecting automotive dealers with banks, finance companies, credit unions and other financing sources, and other service and information providers, such as aftermarket providers and the major credit reporting agencies. We have established a network of active relationships in the United States, which as of June 30, 2008, consisted of over 21,700 dealers, including approximately 90% of all franchised dealers; over 650 financing sources and a number of other service and information providers to the automotive retail industry. We consider a financing source to be active in our network as of a date if it has accepted credit application data electronically from dealers in the DealerTrack network in that month, including financing sources visible to dealers through drop down menus. This counting methodology reflects revisions we made in July 2008 to more accurately reflect the number of financing sources available on the network. Prior to this revision only financing sources available on a primary menu were counted. Our credit application processing product enables dealers to automate and accelerate the indirect automotive financing process by increasing the speed of communications between these dealers and their financing sources. We have leveraged our leading market position in credit application processing to address other inefficiencies in the automotive retail industry value chain. We believe our proven network provides a competitive advantage for distribution of our software and data solutions. Our integrated subscription-based software products and services enable our dealer customers to manage their dealership data and operations, receive valuable consumer leads, compare various financing and leasing options and programs, sell insurance and other aftermarket products, analyze inventory, document compliance with certain laws and execute financing contracts electronically. We have also created efficiencies for financing source customers by providing a comprehensive digital and electronic contracting solution. In addition, we offer data and other products and services to various industry participants, including lease residual value and automobile configuration data.

**2. Basis of Presentation**

The accompanying unaudited consolidated financial statements as of June 30, 2008 and for the three and six months ended June 30, 2008 and 2007 have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required for a complete set of financial statements in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments, consisting only of normal and recurring adjustments, considered necessary for a fair statement have been included in the accompanying unaudited consolidated financial statements. All intercompany transactions and balances have been eliminated in consolidation. Operating results for the three and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2008. The December 31, 2007 balance sheet information has been derived from the audited 2007 consolidated financial statements, but does not include all disclosures required for a complete set of financial statements in accordance with accounting principles generally accepted in the United States of America. For further information, please refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission (SEC) on February 28, 2008.

**3. Recent Accounting Pronouncements**

In April 2008, the FASB issued FSP SFAS No. 142-3 *Determination of the Useful Life of Intangible Assets* (FSP SFAS No. 142-3). FSP SFAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142,

*Goodwill and Other Intangible Assets*. The intent of FSP SFAS No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under other accounting principles generally accepted in the United States of America. FSP SFAS No. 142-3 is effective for financial statements issued for fiscal years beginning after

December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The guidance for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after the effective date. Certain disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date.

In February 2008, the FASB issued FSP SFAS No. 157-2, *Effective Date of FASB Statement 157*, delaying the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We are currently evaluating the impact that this statement will have on our consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We have elected not to apply SFAS No. 159 to any of our existing assets or liabilities.

**Table of Contents****4. Fair Value Measurements**

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157), which defines the fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair values are as follows:

Level 1 Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2 Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3 Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

We have segregated all financial assets that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date in the table below.

Assets measured at fair value on a recurring basis include the following as of June 30, 2008 (in thousands):

|                            | <b>Quoted<br/>Prices in<br/>Active<br/>Markets<br/><br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/><br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/><br/>(Level 3)</b> | <b>Total<br/>Carrying<br/>Value at<br/>June 30,<br/>2008</b> |
|----------------------------|-----------------------------------------------------------------------|---------------------------------------------------------------------------|-------------------------------------------------------------------|--------------------------------------------------------------|
| Cash equivalents (1)       | \$ 14,550                                                             | \$                                                                        | \$                                                                | \$ 14,550                                                    |
| Short-term investments (2) | 35,345                                                                |                                                                           |                                                                   | 35,345                                                       |
| Long-term investments (3)  |                                                                       |                                                                           | 12,842                                                            | 12,842                                                       |
| <b>Total</b>               | <b>\$ 49,895</b>                                                      | <b>\$</b>                                                                 | <b>\$ 12,842</b>                                                  | <b>\$ 62,737</b>                                             |

(1) Cash equivalents consist primarily of money market funds with original maturity dates of three months or less, for which we determine fair value through quoted market

prices.

(2) Short-term investments consist primarily of corporate bonds and municipal commercial paper with maturity dates of one year or less, for which we determine fair value through quoted market prices.

(3) Non-current investments consist of auction rate securities (ARS) that are invested in tax-exempt and tax-advantaged preferred stock trust securities. We classify investment securities as available for sale, and as a result, report the investments at fair value. Auction rate securities have long-term underlying maturities, but have interest rates that are reset every six months or less. Our intent is not to hold these securities to maturity, but rather to use the

interest rate  
reset feature to  
provide liquidity  
as necessary.

Our investment  
in these  
securities  
generally  
provides higher  
interest rates  
than money  
market and  
other cash  
equivalent  
investments.

Due to the lack  
of observable  
market quotes  
on our ARS  
portfolio due to  
failed auctions  
within the  
industry, we  
utilize valuation  
models that rely  
exclusively on  
Level 3 inputs  
including those  
that are based  
on expected  
cash flow  
streams,  
including  
assessments of  
counterparty  
credit quality,  
default risk  
underlying the  
security,  
discount rates  
and overall  
capital market  
liquidity. The  
valuation of our  
ARS investment  
portfolio is  
subject to  
uncertainties  
that are difficult  
to predict. If the  
issuers of these

securities are unable to successfully complete future auctions or refinance their obligations and their credit ratings deteriorate, we may be required to adjust the carrying value of these securities and recognize an impairment charge for an other-than temporary decline in the fair value. We believe that we will be able to liquidate our investment without material loss and that these securities are not permanently impaired, however, due to the uncertainty of whether we will be able to sell these securities within the next year we have classified our ARS as long-term at June 30, 2008. Based on our available cash and other investments, we do not currently anticipate that the lack of liquidity caused

by failed  
 auctions will  
 have a material  
 adverse effect  
 on our operating  
 cash flows or  
 will affect our  
 ability to  
 operate our  
 business as  
 usual.

The change in the carrying amount of Level 3 investments for the six months ended June 30, 2008 is as follows (in thousands):

|                                                                      |            |
|----------------------------------------------------------------------|------------|
| Balance as of January 1, 2008                                        | \$ 169,580 |
| Net sales of auction rate securities                                 | (156,280)  |
| Unrealized losses included in accumulated other comprehensive income | (458)      |
| <br>                                                                 |            |
| Balance as of June 30, 2008                                          | \$ 12,842  |



**Table of Contents****5. Net Income per Share**

For the three and six months ended June 30, 2008 and 2007, we computed net income per share in accordance SFAS No. 128, *Earnings per Share* (SFAS No. 128). Under the provisions of SFAS No. 128, basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding, assuming dilution, during the period. The diluted earnings per share calculation assumes that (i) all stock options, which are in the money are exercised at the beginning of the period and the proceeds are used by us to purchase shares at the average market price for the period and (ii) if applicable, unvested awards that are considered to be contingently issuable shares because they contain either a performance or market condition will be included in diluted earnings per share in accordance with SFAS No. 128 if dilutive and if their conditions (a) have been satisfied at the reporting date or (b) would have been satisfied if the reporting date was the end of the contingency period.

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

|                                                                                                | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|------------------------------------------------------------------------------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                                                                                                | <b>2008</b>                        | <b>2007</b> | <b>2008</b>                      | <b>2007</b> |
| <b>Numerator:</b>                                                                              |                                    |             |                                  |             |
| Net income                                                                                     | \$ 3,066                           | \$ 6,284    | \$ 5,404                         | \$ 11,109   |
| <b>Denominator:</b>                                                                            |                                    |             |                                  |             |
| Weighted average common stock outstanding (basic)                                              | 41,505,503                         | 38,748,405  | 41,569,468                       | 38,685,500  |
| Common equivalent shares from options to purchase common stock and restricted common stock (1) | 1,258,583                          | 1,821,588   | 1,293,938                        | 1,751,770   |
| Weighted average common stock outstanding (diluted)                                            | 42,764,086                         | 40,569,993  | 42,863,406                       | 40,437,270  |
| Basic net income per share                                                                     | \$ 0.07                            | \$ 0.16     | \$ 0.13                          | \$ 0.29     |
| Diluted net income per share                                                                   | \$ 0.07                            | \$ 0.15     | \$ 0.13                          | \$ 0.27     |

(1) In accordance with SFAS No. 128, for the three and six months ended June 30, 2008 and June 30, 2007, we have excluded 393,333 and 290,000 contingently

issuable shares, respectively, from diluted weighted average common stock outstanding as their contingent conditions (a) have not been satisfied at the reporting date nor (b) would have been satisfied if the reporting date was the end of the contingency period (Refer to Note 15 for further information).

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:

|                         | <b>Three Months Ended June</b> |                | <b>Six Months Ended June 30,</b> |                |
|-------------------------|--------------------------------|----------------|----------------------------------|----------------|
|                         | <b>2008</b>                    | <b>2007</b>    | <b>2008</b>                      | <b>2007</b>    |
| Stock options           | 2,342,710                      | 488,966        | 2,209,070                        | 431,245        |
| Restricted common stock | 177,194                        |                | 177,317                          | 101,300        |
| <b>Total</b>            | <b>2,519,904</b>               | <b>488,966</b> | <b>2,386,387</b>                 | <b>532,545</b> |

**Table of Contents****6. Comprehensive Income**

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

|                                                  | Three Months Ended June |           | Six Months Ended June |           |
|--------------------------------------------------|-------------------------|-----------|-----------------------|-----------|
|                                                  | 2008                    | 2007      | 2008                  | 2007      |
| Net income                                       | \$ 3,066                | \$ 6,284  | \$ 5,404              | \$ 11,109 |
| Foreign currency translation adjustments         | 406                     | 4,182     | (1,633)               | 4,913     |
| Unrealized loss on available-for-sale securities | (56)                    |           | (342)                 |           |
| Total                                            | \$ 3,416                | \$ 10,466 | \$ 3,429              | \$ 16,022 |

For the three and six months ended June 30, 2008, the foreign currency translation adjustment primarily represents the effect on translating the intangibles and goodwill related to the Curomax acquisition.

**7. Stock-Based Compensation Expense**

We have three types of stock-based compensation programs: stock options, restricted common stock, and an employee stock purchase plan (ESPP). For further information see Notes 2 and 12 included in our Annual Report on Form 10-K for the year ended December 31, 2007.

The following summarizes stock-based compensation expense recognized for the three and six months ended June 30, 2008 and 2007 (in thousands):

|                                        | Three Months Ended June |          | Six Months Ended June |          |
|----------------------------------------|-------------------------|----------|-----------------------|----------|
|                                        | 2008                    | 2007     | 2008                  | 2007     |
| Stock options                          | \$ 2,083                | \$ 1,473 | \$ 4,013              | \$ 2,698 |
| Restricted common stock                | 1,378                   | 904      | 2,789                 | 1,732    |
| ESPP                                   | 73                      | 69       | 193                   | 145      |
| Total stock-based compensation expense | \$ 3,534                | \$ 2,446 | \$ 6,995              | \$ 4,575 |

Stock-based compensation expense recognized for the three months ended June 30, 2008 was \$3.5 million, of which \$3.1 million was in accordance with FAS 123(R) and \$0.4 million in accordance with APB 25. Stock-based compensation expense recognized for the three months ended June 30, 2007 was \$2.4 million, of which \$1.9 million was in accordance with FAS 123(R) and \$0.5 million in accordance with APB 25.

Stock-based compensation expense recognized for the six months ended June 30, 2008 was \$7.0 million, of which \$6.2 million was in accordance with FAS 123(R) and \$0.8 million in accordance with APB 25. Stock-based compensation expense recognized for the six months ended June 30, 2007 was \$4.6 million, of which \$3.5 million was in accordance with FAS 123(R) and \$1.1 million in accordance with APB 25.

Included in the stock-based compensation expense for restricted common stock for the three and six months ended June 30, 2008 was \$0.4 million and \$0.7 million, respectively, related to the long-term incentive equity awards. Included in the stock-based compensation expense for restricted common stock for the three and six months ended June 30, 2007 was \$0.3 million and \$0.6 million, respectively, related to the long-term incentive equity awards. Refer to Note 15 for further information regarding our long-term incentive equity awards.

**8. Stock Repurchase Program**

On March 18, 2008, the board of directors authorized a stock repurchase program under which we may spend up to \$75.0 million to repurchase shares of our common stock. Stock repurchases under this program may be made on the open market, through 10b5-1 programs, or in privately negotiated transactions in accordance with all applicable laws,

rules and regulations. The transactions may be made from time to time without prior notice and in such amounts as our management deems appropriate and will be funded from cash on hand. The number of shares to be repurchased and the timing of repurchases will be based on several factors, including the price of our common stock, legal or regulatory requirements, general business and market conditions, and other investment opportunities. The stock repurchase program will expire on March 31, 2009, but may be limited or terminated at any time by our Board of Directors without prior notice. From inception of the program through June 30, 2008, we repurchased approximately 1.0 million shares of common stock for an aggregate price of approximately \$19.1 million. Refer to Note 20 for subsequent purchases of stock after June 30, 2008.

**Table of Contents****9. Related Party Transactions**

We entered into several agreements with a stockholder and its affiliates that is a service provider for automotive dealers. These automotive dealers may utilize our network to access customer credit reports and customer leads provided by or through this related party. We earn revenue from this related party for each credit report or customer lead that is accessed using our web-based service. The total amount of net revenue from this related party for the three months ended June 30, 2008 and 2007 was \$0.6 million and \$0.6 million, respectively. The total amount of net revenue from this related party for the six months ended June 30, 2008 and 2007 was \$1.3 million and \$1.2 million, respectively. The total amount of accounts receivable from this related party as of June 30, 2008 and December 31, 2007 was \$0.3 million and \$0.2 million, respectively.

**10. Property and Equipment**

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

|                                                 | <b>Estimated<br/>Useful<br/>Life<br/>(Years)</b> | <b>June 30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|-------------------------------------------------|--------------------------------------------------|--------------------------|----------------------------------|
| Computer equipment                              | 3                                                | \$ 18,167                | \$ 16,719                        |
| Office equipment                                | 5                                                | 3,079                    | 2,189                            |
| Furniture and fixtures                          | 5                                                | 3,070                    | 2,840                            |
| Leasehold improvements                          | 5-11                                             | 1,148                    | 992                              |
| <br>                                            |                                                  |                          |                                  |
| Total property and equipment, gross             |                                                  | 25,464                   | 22,740                           |
| Less: Accumulated depreciation and amortization |                                                  | (12,135)                 | (9,948)                          |
| <br>                                            |                                                  |                          |                                  |
| Total property and equipment, net               |                                                  | \$ 13,329                | \$ 12,792                        |

Depreciation and amortization expense related to property and equipment for the three months ended June 30, 2008 and 2007 was \$1.4 million and \$0.9 million, respectively. Depreciation and amortization expense for the six months ended June 30, 2008 and 2007 was \$2.8 million and \$1.7 million, respectively. Depreciation and amortization are calculated on a straight line basis over the estimated useful life of the asset.

**11. Intangible Assets**

Intangible assets principally are comprised of customer contracts, database, trade names, patents, technology, non-competition agreements, and partner agreements. The amortization expense relating to intangible assets is recorded as a cost of revenue. The gross book value, accumulated amortization and amortization periods of the intangible assets were as follows (dollars in thousands):

|                       | <b>June 30, 2008</b>            |                                     | <b>December 31, 2007</b>        |                                     | <b>Amortization<br/>Period<br/>(Years)</b> |
|-----------------------|---------------------------------|-------------------------------------|---------------------------------|-------------------------------------|--------------------------------------------|
|                       | <b>Gross<br/>Book<br/>Value</b> | <b>Accumulated<br/>Amortization</b> | <b>Gross<br/>Book<br/>Value</b> | <b>Accumulated<br/>Amortization</b> |                                            |
| Customer contracts    | \$ 36,713                       | \$ (13,896)                         | \$ 41,569                       | \$ (14,789)                         | 2-4                                        |
| Database              | 13,333                          | (7,836)                             | 16,433                          | (9,577)                             | 3-6                                        |
| Trade names           | 10,500                          | (4,964)                             | 10,500                          | (4,460)                             | 5-10                                       |
| Patents/technology    | 20,763                          | (6,123)                             | 35,212                          | (16,618)                            | 2-5                                        |
| Non-compete agreement | 11,413                          | (6,265)                             | 14,062                          | (6,214)                             | 1-5                                        |
| Partner agreements    | 4,400                           | (2,067)                             | 4,400                           | (1,029)                             | 5                                          |

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|       |           |             |            |             |   |
|-------|-----------|-------------|------------|-------------|---|
| Other |           |             | 900        | (861)       | 5 |
| Total | \$ 97,122 | \$ (41,151) | \$ 123,076 | \$ (53,548) |   |

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Amortization expense related to intangibles for the three months ended June 30, 2008 and 2007 was \$6.5 million and \$6.7 million, respectively. Amortization expense for the six months ended June 30, 2008 and 2007 was \$14.1 million and \$12.2 million, respectively. Amortization expense that will be charged to income for the remaining period of 2008, based on the June 30, 2008 book value, is approximately \$11.1 million.

Amortization expense that will be charged to income for the subsequent five years and thereafter is estimated, based on the June 30, 2008 book value, to be \$19.0 million in 2009, \$15.5 million in 2010, \$6.6 million in 2011, \$2.0 million in 2012, \$0.7 million in 2013 and thereafter \$1.0 million.

Included in the gross book value as of June 30, 2008 and December 31, 2007, is foreign currency translation of \$0.1 million and \$3.3 million, respectively.

**12. Goodwill**

The change in carrying amount of goodwill for the six months ended June 30, 2008 is as follows (in thousands):

|                                                   |                |
|---------------------------------------------------|----------------|
| Balance as of January 1, 2008                     | \$ 117,702     |
| Impact of change in Canadian dollar exchange rate | (717)          |
| Other                                             | (887)          |
| <br>Balance as of June 30, 2008                   | <br>\$ 116,098 |

**13. Other Accrued Liabilities**

Following is a summary of the components of other accrued liabilities (in thousands):

|                                     | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|-------------------------------------|--------------------------|------------------------------|
| Customer deposits                   | \$ 2,755                 | \$ 2,773                     |
| Professional fees                   | 2,616                    | 1,462                        |
| Revenue share                       | 2,151                    | 1,196                        |
| Other                               | 1,801                    | 920                          |
| Taxes                               | 1,607                    | 3,379                        |
| Software licenses                   | 287                      | 1,212                        |
| Public company costs                | 235                      | 174                          |
| Severance                           | 80                       | 271                          |
| <br>Total other accrued liabilities | <br>\$ 11,532            | <br>\$ 11,387                |

**14. Income Taxes**

We adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an *Interpretation of FASB Statement No. 109 of FIN 48*, on January 1, 2007. FIN 48 specifies the way public companies are to account for uncertainty in income tax reporting, and prescribes the methodology for recognizing, reversing, and measuring the tax benefits of a tax position taken, or expected to be taken, in a tax return. Our adoption of FIN 48 did not result in any change to the level of our liability for uncertain tax positions, and there was no adjustment to our retained earnings for the cumulative effect of an accounting change. At January 1, 2008, the total liability for uncertain tax positions recorded in our balance sheet in accrued other liabilities was \$0.1 million.

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 has completed its examination of our federal income tax returns through 2004.

Interest and penalties 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. At January 1, 2008, the

combined amount of accrued interest and penalties related to tax positions taken on our tax returns was zero. There was no significant change to this amount during the first six months of 2008.

**15. Long-Term Incentive Equity Awards**

On August 2, 2006, November 2, 2006, and July 21, 2007, the compensation committee of the board of directors granted long-term performance equity awards (under the 2005 Incentive Award Plan) consisting of 565,000 shares, 35,000 shares, and 10,000 shares of restricted common stock, respectively, to certain executive officers and other employees. Each individual's award is allocated 50% to achieving earnings before interest, taxes, depreciation and amortization, as adjusted to reflect any future acquisitions (EBITDA Performance Award) and 50% to the market value of our common stock (Market Value Award). The awards are earned upon our achievement of EBITDA and market-based targets for the fiscal years 2007, 2008 and 2009, but will not vest unless the grantee remains continuously employed in active service until January 31, 2010. If an EBITDA Performance Award or Market Value Award is not earned in an earlier year, it can be earned upon achievement of that target in a subsequent year. The awards will accelerate in full upon a change in control, if any.



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In accordance with FAS 123(R), we valued the EBITDA Performance Award and the Market Value Award using the Black-Scholes and binomial lattice-based valuation pricing models, respectively. The total fair value of the entire EBITDA Performance Award is \$6.0 million (prior to estimated forfeitures), of which, in January 2007, we began expensing on a straight-line basis the amount associated with the 2007 award as it was deemed probable that the threshold for the year ending December 31, 2007 would be met. We have met the EBITDA target for 2007. The total value of the entire Market Value Award is \$2.5 million (including estimated forfeitures), which is expensed on a straight-line basis from the date of grant over the applicable service period. As long as the service condition is satisfied, the expense is not reversed, even if the market conditions are not satisfied. As of June 30, 2008, we have not begun to expense the EBITDA Performance Awards for 2008 and 2009 as it has not been deemed probable that the targets will be achieved. We will continue to evaluate the probability of achieving the target on a quarterly basis.

The expense recorded related to the EBITDA Performance Award and the Market Value Award for the three and six months ended June 30, 2008 and 2007 is as follows (in thousands):

|                          | Three Months Ended June |        | Six Months Ended June |        |
|--------------------------|-------------------------|--------|-----------------------|--------|
|                          | 30,<br>2008             | 2007   | 30,<br>2008           | 2007   |
| EBITDA Performance Award | \$ 167                  | \$ 148 | \$ 334                | \$ 296 |
| Market Value Award       | 187                     | 173    | 374                   | 346    |
| Total                    | \$ 354                  | \$ 321 | \$ 708                | \$ 642 |

The EBITDA Performance Award and Market Value Award expense is included in restricted common stock in the stock-based compensation expense table in Note 7.

**16. Commitments and Contingencies*****Retail Sales Tax***

The Ontario Ministry of Revenue (the Ministry) has conducted a retail sales tax field audit on the financial records of our Canadian subsidiary, DealerTrack Canada, Inc. (formerly known as DealerAccess Canada, Inc.), for the period from March 1, 2001 through May 31, 2003. We received a formal assessment from the Ministry indicating unpaid Ontario retail sales tax totaling approximately \$0.2 million, plus interest. Although we are disputing the Ministry's findings, the assessment, including interest, has been paid in order to avoid potential future interest and penalties.

As part of the purchase agreement dated, December 31, 2003 between us and Bank of Montreal for the purchase of 100% of the issued and outstanding capital stock of DealerAccess, Inc., Bank of Montreal agreed to indemnify us specifically for this potential liability for all sales tax periods prior to January 1, 2004. The potential sales tax liability for the period covered by this indemnification is now closed due to the statutory expiration of the periods open for audit by the Ministry. To date, all amounts paid to the Ministry by us for this assessment have been reimbursed by the Bank of Montreal under this indemnity.

We undertook a comprehensive review of the audit findings of the Ministry using external tax experts. Our position has been that our financing source revenue transactions are not subject to Ontario retail sales tax. We filed a formal Notice of Objection with the Ministry on December 12, 2005. We received a letter dated November 2, 2007 from an appeals officer of the Ministry stating that the assessment was, in his opinion, properly raised and his intention was to recommend his confirmation to senior management of the Ministry. The officer agreed, however, to defer his recommendation for a period of thirty business days to enable us to submit any additional information not yet provided. We submitted additional information to the Ministry to support our position that the services are not subject to sales tax.

We received a letter dated December 21, 2007 from the Ministry stating that no change should be made to the appeals officer's opinion. The letter further stated that we had ninety days from the date of the letter to file a Notice of Appeal with the Superior Court of Justice. A Notice of Appeal was filed on our behalf on March 18, 2008 to challenge the assessment because we did not believe these services are subject to sales tax. We have not accrued any related

sales tax liability for the period subsequent to May 31, 2003, for these financing source revenue transactions. This appeal is supported by the financial institutions whose source revenue transactions were subject to the assessment. These financial institutions have agreed to participate in the cost of the litigation.

In the event we are obligated to charge sales tax for this type of transaction, this Canadian subsidiary's contractual arrangements with its financing source customers obligate these customers to pay all sales taxes that are levied or imposed by any taxing authority by reason of the transactions contemplated under the particular contractual arrangement. In the event of any failure to pay such amounts, we would be required to pay the obligation, which could range from \$3.9 million (CAD) to \$4.3 million (CAD), including penalties and interest.

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### ***Commitments***

Pursuant to employment or severance agreements with certain employees, we have a commitment to pay severance of approximately \$7.8 million as of June 30, 2008 and \$7.5 million as of December 31, 2007, 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.

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 such payment. 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.

### ***Legal Proceedings***

From time to time, we are a party to litigation matters arising in connection with the normal course of our 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. RouteOne LLC***

On January 28, 2004, we filed a Complaint and Demand for Jury Trial against RouteOne LLC (RouteOne) in the United States District Court for the Eastern District of New York, Civil Action No. CV 04-322 (SJF). The complaint sought injunctive relief as well as damages against RouteOne for infringement of two patents owned by us, which relate to computer implemented automated credit application analysis and decision routing inventions (the Patents). The complaint also sought relief for RouteOne's acts of copyright infringement, circumvention of technological measures and common law fraud and unfair competition.

The court approved a joint stipulation of dismissal with respect to this action. Pursuant to the joint stipulation, the patent count has been dismissed without prejudice to be pursued as part of the below consolidated actions and all other counts have been dismissed with prejudice.

#### ***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 seeks declaratory and injunctive relief, as well as, damages against the defendants for infringement of the Patents. We also are seeking relief for acts of copyright infringement and unfair competition.

On June 8, 2006, David Huber and Finance Express filed their answer and counterclaims. The counterclaims seek damages for libel related to an allegation in the complaint, breach of contract, deceit, actual and constructive fraud, misappropriation of trade secrets and unfair competition related to a confidentiality agreement between the parties. On October 26, 2006, the Court dismissed the counterclaim for libel pursuant to a motion by us.

On October 27, 2006, 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-06-6864 (SJF). The complaint seeks declaratory and injunctive relief as well as damages against the defendants for infringement of the Patents. On November 28, 2006 and December 4, 2006, respectively, defendants RouteOne, David Huber and Finance Express filed their answers. Finance Express also asserted counterclaims for

breach of contract, deceit, actual and constructive fraud, misappropriation of trade secrets and unfair competition related to a confidentiality agreement between Finance Express and us.

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 seeks declaratory and injunctive relief as well as damages against the defendants for infringement of U. S. Pat. 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. RouteOne, David Huber and Finance Express asserted counterclaims for a declaratory judgment of unenforceability due to inequitable conduct with respect to the 427 Patent and the Patents. David Huber and Finance Express also asserted counterclaims for breach of contract, deceit, actual and constructive fraud, misappropriation of trade secrets and unfair competition related to a confidentiality agreement between Finance Express and us.

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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, have been 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 are completed, as well as motions for summary judgment.

On July 21, 2008, the court resolved disputed issues of inventorship, validity, inequitable conduct, and RouteOne's exposure to a willful infringement claim, in our favor. These rulings eliminate certain defenses by RouteOne and Finance Express and allow our damages to be trebled if RouteOne's infringement is found to be willful at trial.

A decision in the Markman hearing has not yet been issued. The court deferred rulings on two additional summary judgment motions pending its upcoming Markman ruling, in which the court will decide the meaning of certain terms in the patent claims. The court also denied our motion to remove one defense, reserving it for trial because of questions of fact.

The parties are preparing for the trial that is currently scheduled to begin on October 28, 2008.

We intend to pursue our claims and defend any counterclaims vigorously.

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

**17. Segment Information**

In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS No. 131) segment information is being reported consistent with our method of internal reporting. In accordance with SFAS No. 131, 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 under SFAS No. 131. For enterprise-wide disclosure, we are organized primarily on the basis of service lines. Revenue earned outside of the United States for the three and six months ended June 30, 2008, is approximately 11% and 12% of our total revenue, respectively. Revenue earned outside of the United States for the three and six months ended June 30, 2007 was less than 10% of our total net revenue.

Supplemental disclosure of revenue by service type is as follows (in thousands):

|                               | Three Months Ended June |           | Six Months Ended June |            |
|-------------------------------|-------------------------|-----------|-----------------------|------------|
|                               | 2008                    | 2007      | 2008                  | 2007       |
| Transaction services revenue  | \$ 36,321               | \$ 38,596 | \$ 74,488             | \$ 72,886  |
| Subscription services revenue | 22,877                  | 17,444    | 45,263                | 33,213     |
| Other                         | 3,983                   | 2,467     | 7,738                 | 4,133      |
| Total net revenue             | \$ 63,181               | \$ 58,507 | \$ 127,489            | \$ 110,232 |

**18. Credit Facility**

Our \$25.0 million revolving credit facility expired on April 15, 2008, pursuant to its terms. The facility had an interest rate of LIBOR plus 150 basis points or Prime plus 50 basis points, and was available for general corporate purposes (including acquisitions), subject to certain conditions.

**19. Second Amended and Restated DealerTrack Holdings, Inc. 2005 Incentive Award Plan**

On June 3, 2008, our stockholders approved a proposal to amend and restate our Amended and Restated DealerTrack Holdings, Inc. 2005 Incentive Award (2005 Plan) to, among other things, increase the aggregate number of shares authorized for issuance under the 2005 Plan by 1,550,000 shares. After giving effect to these additional shares there is an aggregate of 10,285,465 shares of common stock that have been reserved for issuance pursuant to the 2005 Plan. As of June 30, 2008, 1,595,701 shares were available for future issuance.

**20. Subsequent Event**

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During July 2008, pursuant to the stock repurchase program discussed in Note 8, we repurchased approximately 1.0 million shares of common stock for an aggregate price of approximately \$14.9 million.

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**Table of Contents****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 (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements involve a number of risks, uncertainties and other factors that could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that could materially affect such forward-looking statements can be found in the section entitled Risk Factors in Part I, Item 1A. in our Annual Report on Form 10-K for the year ended December 31, 2007 filed with the SEC on February 28, 2008. 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 will undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances.*

**Overview**

DealerTrack is a leading provider of on-demand software, and data solutions for the automotive retail industry in the United States. Utilizing the Internet, we have built a network connecting automotive dealers with banks, finance companies, credit unions and other financing sources, and other service and information providers, such as aftermarket providers and the major credit reporting agencies. We have established a network of active relationships in the United States, which as of June 30, 2008, consisted of over 21,700 automotive dealers, including approximately 90% of all franchised dealers; over 650 financing sources and a number of other service and information providers to the automotive retail industry. We consider a financing source to be active in our network as of a date if it has accepted credit application data electronically from dealers in the DealerTrack network in that month, including financing sources visible to dealers through drop down menus. This counting methodology reflects revisions we made in July 2008 to more accurately reflect the number of financing sources available on the network. Prior to this revision only financing sources available on a primary menu were counted. Our credit application processing product enables dealers to automate and accelerate the indirect automotive financing process by increasing the speed of communications between these dealers and their financing sources. We have leveraged our leading market position in credit application processing to address other inefficiencies in the automotive retail industry value chain. We believe our proven network provides a competitive advantage for distribution of our software and data solutions. Our integrated subscription-based software products and services enable our dealer customers to manage their dealership data and operations, receive valuable consumer leads, compare various financing and leasing options and programs, sell insurance and other aftermarket products, analyze inventory, document compliance with certain laws and execute financing contracts electronically. We have also created efficiencies for financing source customers by providing a comprehensive digital and electronic contracting solution. In addition, we offer data and other products and services to various industry participants, including lease residual value and automobile configuration data.

We are a Delaware corporation formed in August 2001. We are organized as a holding company and conduct a substantial amount of our business through our subsidiaries including Automotive Lease Guide (alg), Inc., Arkona, Inc., DealerTrack Accessories Solutions, Inc., Chrome Systems, Inc., DealerTrack Aftermarket Services, Inc., DealerTrack Canada, Inc., DealerTrack Digital Services, Inc., and DealerTrack, Inc.

We monitor our performance as a business using a number of measures that are not found in our consolidated financial statements. These measures include the number of active dealers and financing sources in the DealerTrack network, the number of transactions processed and the number of product subscriptions. We believe that improvements in these metrics will result in improvements in our financial performance over time. We also view the acquisition and successful integration of acquired companies as important milestones in the growth of our business as these acquired companies bring new products to our customers and expand our technological capabilities. We believe that successful acquisitions will also lead to improvements in our financial performance over time. In the near term, however, the purchase accounting treatment of acquisitions can have a negative impact on our net income as the depreciation and amortization expenses associated with acquired assets, as well as particular intangibles (which tend to have a relatively short useful life), can be substantial in the first several years following an acquisition. As a result,

we monitor our EBITDA and other business statistics as a measure of operating performance in addition to net income and the other measures included in our consolidated financial statements.

The following is a table consisting of EBITDA and certain other business statistics that management is continually monitoring (amounts in thousands, except active dealers, financing source data, and product subscriptions):

|                                                                 | Three Months Ended June |           | Six Months Ended June 30, |           |
|-----------------------------------------------------------------|-------------------------|-----------|---------------------------|-----------|
|                                                                 | 2008                    | 2007      | 2008                      | 2007      |
| <b>EBITDA and Other Business Statistics:</b>                    |                         |           |                           |           |
| EBITDA (1)                                                      | \$ 13,894               | \$ 18,853 | \$ 27,238                 | \$ 33,496 |
| Capital expenditures, software and web site development costs   | \$ 5,027                | \$ 2,253  | \$ 7,941                  | \$ 5,700  |
| Active dealers in our network as of end of the period (2)       | 21,735                  | 22,630    | 21,735                    | 22,630    |
| Active financing sources in our network as of end of period (3) | 659                     | 447       | 659                       | 447       |
| Transactions processed (4)                                      | 21,047                  | 23,498    | 44,936                    | 46,223    |
| Product subscriptions (5)                                       | 31,499                  | 25,621    | 31,499                    | 25,621    |

(1) EBITDA represents net income before interest (income) expense, taxes, depreciation and amortization. We present EBITDA because we believe that EBITDA provides useful information with respect to the performance of our fundamental business activities and is also frequently used by securities analysts, investors and other interested parties in the evaluation of comparable companies. We rely on EBITDA as a primary measure to review and assess the operating performance of our company and management team



in connection with  
our executive  
compensation plan  
incentive  
payments.

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EBITDA has limitations as an analytical tool and you should not consider it in isolation, or as a substitute for analysis of our results as reported under Generally Accepted Accounting Principles (GAAP). Some of these limitations are:

EBITDA does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;

EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debts;

Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements; and

Other companies may calculate EBITDA differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, EBITDA should not be considered as a measure 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 EBITDA only supplementally. EBITDA is a measure of our performance that is not required by, or presented in accordance with, GAAP. EBITDA is not a measurement of our financial performance under GAAP and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with GAAP or as an alternative to cash flow from operating activities as a measure of our liquidity.

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

|                                                                                                   | <b>Three Months Ended June</b> |                  | <b>Six Months Ended June</b> |                  |
|---------------------------------------------------------------------------------------------------|--------------------------------|------------------|------------------------------|------------------|
|                                                                                                   | <b>30,</b>                     | <b>30,</b>       | <b>30,</b>                   | <b>30,</b>       |
|                                                                                                   | <b>2008</b>                    | <b>2007</b>      | <b>2008</b>                  | <b>2007</b>      |
| GAAP net income                                                                                   | \$ 3,066                       | \$ 6,284         | \$ 5,404                     | \$ 11,109        |
| Interest income                                                                                   | (1,145)                        | (1,220)          | (2,708)                      | (2,751)          |
| Interest expense                                                                                  | 74                             | 73               | 166                          | 135              |
| Provision for income taxes                                                                        | 2,213                          | 4,618            | 4,168                        | 8,059            |
| Depreciation of property and equipment and amortization of capitalized software and website costs | 3,185                          | 2,429            | 6,081                        | 4,705            |
| Amortization of acquired identifiable intangibles                                                 | 6,501                          | 6,669            | 14,127                       | 12,239           |
| <b>EBITDA (Non-GAAP)</b>                                                                          | <b>\$ 13,894</b>               | <b>\$ 18,853</b> | <b>\$ 27,238</b>             | <b>\$ 33,496</b> |

- (2) We consider a dealer to be active as of a date if the dealer completed at least one revenue-generating

credit application processing transaction using the DealerTrack network during the most recently ended calendar month.

(3) We consider a financing source to be active in our network as of a date if it is accepting credit application data electronically from dealers in the DealerTrack network, including financing sources visible to dealers through drop down menus. These numbers reflect a change in counting methodology to reflect financing sources available through drop down menus.

(4) Represents revenue-generating transactions processed in the DealerTrack, DealerTrack Digital Services and DealerTrack Canada networks at the end of a given period.

(5) Represents revenue-generating subscriptions in the DealerTrack and DealerTrack Canada networks at the end of a given period.

**Revenue**

*Transaction Services Revenue.* Transaction services revenue consists of revenue earned from our financing source customers for each credit application or contract that dealers submit to them. We also earn transaction services revenue from financing source customers for each financing contract executed via our electronic contracting and digital contract processing solutions, as well as for any portfolio residual value analyses we perform for them. We also earn transaction services revenue from dealers or other service and information providers, such as aftermarket providers, vehicle sales lead distributors, and credit report providers, for each fee-bearing product accessed by dealers.

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

**Cost of Revenue and Operating Expenses**

*Cost of Revenue.* Cost of revenue primarily consists of expenses related to running our network infrastructure (including Internet connectivity and data storage), amortization expense on acquired intangible assets, compensation and related benefits for network and technology development personnel, amounts paid to third parties pursuant to contracts under which a portion of certain revenue is owed to those third parties (revenue share), direct costs (printing, binding, and delivery) associated with our residual value guides, installation and hardware costs associated with our dealership management system product offering, expenses related to our digital contract business, allocated overhead and amortization associated with capitalization of software.

*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, as well as enhance and maintain 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 to all departments 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 our cost of revenue and each operating expense category.

**Critical Accounting Policies and Estimates**

Our management's discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. 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 in the event unforeseen events occur or should the assumptions used in the estimation process differ from actual results. Management believes there have been no material changes during the six months ended June 30, 2008 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, 2007, filed with the SEC on February 28, 2008.

**Table of Contents****Results of Operations**

The following table sets forth, for the periods indicated, the selected consolidated statements of operations data expressed as a percentage of revenue:

|                                                    | <b>Three Months Ended June</b> |             | <b>Six Months Ended June</b> |             |
|----------------------------------------------------|--------------------------------|-------------|------------------------------|-------------|
|                                                    | <b>30,</b>                     | <b>30,</b>  | <b>30,</b>                   | <b>30,</b>  |
|                                                    | <b>2008</b>                    | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|                                                    | <b>(% of net revenue)</b>      |             | <b>(% of net revenue)</b>    |             |
| <b>Consolidated Statements of Operations Data:</b> |                                |             |                              |             |
| Net revenue                                        | 100.0%                         | 100.0%      | 100.0%                       | 100.0%      |
| Operating costs and expenses:                      |                                |             |                              |             |
| Cost of revenue                                    | 44.1                           | 41.3        | 44.3                         | 41.2        |
| Product development                                | 4.9                            | 3.9         | 4.9                          | 4.2         |
| Selling, general and administrative                | 44.3                           | 38.1        | 45.3                         | 39.6        |
| Total operating costs and expenses                 | 93.3                           | 83.3        | 94.5                         | 85.0        |
| Income from operations                             | 6.7                            | 16.7        | 5.5                          | 15.0        |
| Interest income                                    | 1.8                            | 2.1         | 2.1                          | 2.5         |
| Interest expense                                   | (0.1)                          | (0.2)       | (0.1)                        | (0.1)       |
| Income before provision for income taxes           | 8.4                            | 18.6        | 7.5                          | 17.4        |
| Provision for income taxes                         | (3.5)                          | (7.9)       | (3.3)                        | (7.3)       |
| Net income                                         | 4.9%                           | 10.7%       | 4.2%                         | 10.1%       |

**Three Months Ended June 30, 2008 and 2007****Revenue**

|                               | <b>Three Months Ended</b> |             |
|-------------------------------|---------------------------|-------------|
|                               | <b>June 30,</b>           |             |
|                               | <b>2008</b>               | <b>2007</b> |
| Transaction services revenue  | \$ 36,321                 | \$ 38,596   |
| Subscription services revenue | 22,877                    | 17,444      |
| Other                         | 3,983                     | 2,467       |
| Total net revenue             | \$ 63,181                 | \$ 58,507   |

Total net revenue increased \$4.7 million, or 8%, to \$63.2 million for the three months ended June 30, 2008 from \$58.5 million for the three months ended June 30, 2007.

*Transaction Services Revenue.* Transaction services revenue decreased \$2.3 million, or 6%, to \$36.3 million for the three months ended June 30, 2008 from \$38.6 million for the three months ended June 30, 2007. The decrease was

primarily the result of a decline in the volume of transactions processed through our network to 21.0 million for the three months ended June 30, 2008 from 23.5 million for the three months ended June 30, 2007. The 10% decrease in transaction volume, as compared to the same period of the prior year, resulted in a \$4.2 million reduction in revenue in the current quarter. The tightening of the credit markets caused a significant decline in the number of lending relationships between the various financing sources and automotive dealers available through our network; this, together with the overall decrease in automobile sales has meaningfully impacted our transaction volume compared to historical levels. The revenue decline of \$4.2 million related to the decrease in transaction volume was offset by a \$1.9 million increase in the average transaction price to \$1.73 for the three months ended June 30, 2008 from \$1.64 for the three months ended June 30, 2007. The contributing factor to the increase in average transaction price was the 47% increase in financing source customers active in our network to 659 as of June 30, 2008 from 447 as of June 30, 2007. The additional 212 financing source customers added are lower transaction volume customers with higher price per application tiers.

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*Subscription Services Revenue.* Subscription services revenue increased \$5.5 million, or 31%, to \$22.9 million for the three months ended June 30, 2008 from \$17.4 million for the three months ended June 30, 2007. Revenue growth was favorably impacted by the increase in the total number of subscriptions to 31,499 as of June 30, 2008 from 25,621 as of June 30, 2007, together with a 3% increase in the average subscription price to \$246 for the three months ended June 30, 2008 from \$238 for the three months ended June 30, 2007. These factors contributed \$5.1 million to the increase in revenue which includes \$2.5 million related to acquisitions.

**Cost of Revenue and Operating Expenses**

|                                              | <b>Three Months Ended<br/>June 30,</b> |             |
|----------------------------------------------|----------------------------------------|-------------|
|                                              | <b>2008</b>                            | <b>2007</b> |
| Cost of revenue                              | \$ 27,879                              | \$ 24,158   |
| Product development                          | 3,084                                  | 2,281       |
| Selling, general and administrative          | 28,010                                 | 22,313      |
| <br>                                         |                                        |             |
| Total cost of revenue and operating expenses | \$ 58,973                              | \$ 48,752   |

*Cost of Revenue.* Cost of revenue increased \$3.7 million, or 15%, to \$27.9 million for the three months ended June 30, 2008 from \$24.2 million for the three months ended June 30, 2007. The \$3.7 million increase was primarily the result of increased amortization and depreciation charges of \$0.3 million, increased compensation and benefits related costs of \$1.5 million and increased occupancy and telecommunications costs of \$0.2 million both due to overall headcount additions and salary increases, \$0.6 million of technology expense and \$0.9 million in cost of revenue from our dealer management system business.

*Product Development Expenses.* Product development expenses increased \$0.8 million, or 35%, to \$3.1 million for the three months ended June 30, 2008 from \$2.3 million for the three months ended June 30, 2007. The \$0.8 million increase was primarily a result of increased compensation and related benefit costs of \$0.7 million due to overall headcount additions and salary increases.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased \$5.7 million, or 26%, to \$28.0 million for the three months ended June 30, 2008 from \$22.3 million for the three months ended June 30, 2007. The \$5.7 million increase in selling, general and administrative expenses was primarily the result of increased compensation and related benefit costs of approximately \$2.4 million due to headcount additions and salary increases, \$2.3 million in increased professional fees related primarily to pending litigation and \$0.9 million in increased stock-based compensation expense due to additional stock options and restricted common stock awards granted since June 30, 2007.

**Provision for Income Taxes**

|                                 | <b>Three Months Ended<br/>June 30,</b> |             |
|---------------------------------|----------------------------------------|-------------|
|                                 | <b>2008</b>                            | <b>2007</b> |
| Provision for income taxes, net | \$(2,213)                              | \$(4,618)   |

The provision for income taxes for the three months ended June 30, 2008 of \$2.2 million consisted primarily of \$0.6 million of federal tax expense, \$0.3 million of state and local income taxes, and \$1.3 million of tax expense for our Canadian subsidiary. The provision for income taxes for the three months ended June 30, 2007 of \$4.6 million consisted primarily of \$3.0 million of federal tax expense, \$0.3 million of state and local income taxes, \$0.6 million of adjustments due to a change in the New York State tax rate, and \$0.7 million of tax expense for our Canadian subsidiaries. Included in tax expense for our Canadian subsidiary for the three months ended June 30, 2008 and 2007 is \$0.4 million and \$0.3 million, respectively, for a permanent item relating to intangible amortization. These amounts have a 7% and 3% impact on the effective tax rate for the three months ended June 30, 2008 and 2007, respectively.





**Table of Contents****Six Months Ended June 30, 2008 and 2007****Revenue**

|                               | <b>Six Months Ended<br/>June 30,</b> |             |
|-------------------------------|--------------------------------------|-------------|
|                               | <b>2008</b>                          | <b>2007</b> |
| Transaction services revenue  | \$ 74,488                            | \$ 72,886   |
| Subscription services revenue | 45,263                               | 33,213      |
| Other                         | 7,738                                | 4,133       |
| <br>                          |                                      |             |
| Total net revenue             | \$ 127,489                           | \$ 110,232  |

Total net revenue increased \$17.3 million, or 16%, to \$127.5 million for the six months ended June 30, 2008 from \$110.2 million for the six months ended June 30, 2007.

*Transaction Services Revenue.* Transaction services revenue increased \$1.6 million, or 2%, to \$74.5 million for the six months ended June 30, 2008 from \$72.9 million for the six months ended June 30, 2007. This increase was less than expected due to the decline in the volume of transactions processed through our network to 44.9 million for the six months ended June 30, 2008 from 46.2 million for the six months ended June 30, 2007. The 3% decrease in transaction volume, as compared to the same period for the prior year, resulted in a \$2.1 million reduction in revenue in the first half of 2008. The tightening of the credit markets caused a significant decline in the number of lending relationships between the various financing sources and automotive dealers available through our network; this together with the overall decrease in automobile sales, has meaningfully impacted our transaction volume compared to historical levels. The revenue decline of \$2.1 million related to the decrease in transaction volume was offset by a \$3.6 million increase in the average transaction price to \$1.66 for the six months ended June 30, 2008 from \$1.58 for the six months ended June 30, 2007. The contributing factor to the increase in average transaction price was the 47% increase in financing source customers active in our network to 659 as of June 30, 2008 from 447 as of June 30, 2007. The additional 212 financing source customers added are lower transaction volume customers with higher price per application tiers.

*Subscription Services Revenue.* Subscription services revenue increased \$12.1 million, or 36%, to \$45.3 million for the six months ended June 30, 2008 from \$33.2 million for the six months ended June 30, 2007. Revenue growth was favorably impacted by the increase in the total number of subscriptions to 31,499 as of June 30, 2008 from 25,621 as of June 30, 2007, together with a 6% increase in the average subscription price to \$249 for the six months ended June 30, 2008 from \$236 for the six months ended June 30, 2007. These factors contributed \$11.2 million to the increase in revenue which includes \$5.3 million related to acquisitions.

**Cost of Revenue and Operating Expenses**

|                                              | <b>Six Months Ended<br/>June 30,</b> |             |
|----------------------------------------------|--------------------------------------|-------------|
|                                              | <b>2008</b>                          | <b>2007</b> |
| Cost of revenue                              | \$ 56,491                            | \$ 45,458   |
| Product development                          | 6,226                                | 4,661       |
| Selling, general and administrative          | 57,742                               | 43,561      |
| <br>                                         |                                      |             |
| Total cost of revenue and operating expenses | \$ 120,459                           | \$ 93,680   |

*Cost of Revenue.* Cost of revenue increased \$11.0 million, or 24%, to \$56.5 million for the six months ended June 30, 2008 from \$45.5 million for the six months ended June 30, 2007. The \$11.0 million increase was primarily

the result of increased amortization and depreciation charges of \$2.7 million primarily relating to the acquired identifiable intangibles from our 2007 acquisitions of Arkona, AutoStyleMart, Curomax, and the asset acquisition of certain assets from Manheim Auctions, coupled with increased compensation and related benefits costs of \$3.8 million and increased occupancy and telecommunications costs of \$0.4 million due to overall headcount additions and salary increases, \$1.3 million of technology expense, \$1.7 million in cost of revenue from our dealer management system business and \$0.5 million in cost of revenue from our digital contract business.

*Product Development Expenses.* Product development expenses increased \$1.5 million or 34%, to \$6.2 million for the six months ended June 30, 2008 from \$4.7 million for the six months ended June 30, 2007. The \$1.5 million increase was primarily a result of increased compensation and related benefit costs of \$1.3 million due to headcount additions and salary increases.

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*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased \$14.2 million, or 33%, to \$57.7 million for the six months ended June 30, 2008 from \$43.5 million for the six months ended June 30, 2007. The \$14.2 million increase in selling, general and administrative expenses was primarily the result of increased compensation and related benefit costs of approximately \$5.5 million due to headcount additions and salary increases, \$5.4 million in increased professional fees related primarily to pending litigation, \$2.0 million in increased stock-based compensation expense due to additional stock options and restricted common stock awards granted since June 30, 2007 and \$0.5 million in increased depreciation expense.

**Provision for Income Taxes**

|                                 | <b>Six Months Ended<br/>June 30,</b> |             |
|---------------------------------|--------------------------------------|-------------|
|                                 | <b>2008</b>                          | <b>2007</b> |
| Provision for income taxes, net | \$(4,168)                            | \$(8,059)   |

The provision for income taxes for the six months ended June 30, 2008 of \$4.2 million consisted primarily of \$1.6 million of federal tax expense, \$0.5 million of state and local income taxes, and \$2.1 million of tax expense for our Canadian subsidiary. The provision for income taxes for the six months ended June 30, 2007 of \$8.1 million consisted primarily of \$5.9 million of federal tax expense, \$0.8 million of state and local income taxes, \$0.6 million of adjustments due to a change in the New York State tax rate, and \$0.8 million of tax expense for our Canadian subsidiaries. Included in tax expense for our Canadian subsidiary for the six months ended June 30, 2008 and 2007 is \$0.7 million and \$0.5 million, respectively, for a permanent item relating to intangible amortization. These amounts have a 7% and 3% impact on the effective tax rate for the six months ended June 30, 2008 and 2007, respectively.

**Liquidity and Capital Resources**

Our liquidity requirements will continue to be for working capital, acquisitions, capital expenditures and general corporate purposes. Our capital expenditures, software and web site development costs for the six months ended June 30, 2008 were \$7.9 million, of which \$7.4 million was in cash. We expect to finance our future liquidity needs through working capital and cash flows from operations, however future acquisitions or other strategic initiatives may require us to incur or seek additional financing. On April 15, 2008, our \$25.0 million revolving credit facility expired and was not renewed.

As of June 30, 2008, we had \$168.0 million of cash and cash equivalents, \$35.3 million in short-term investments, \$12.8 million in non-current investments and \$214.5 million in working capital, as compared to \$50.6 million of cash and cash equivalents, \$169.6 million in short-term investments and \$222.8 million in working capital as of December 31, 2007.

Under our stock repurchase program we may spend up to an additional \$55.9 million to purchase our common stock through March 31, 2009, but may be limited or terminated at any time by our Board of Directors without prior notice.

Under the terms of the merger agreement with AutoStyleMart, Inc. and Curomax Corporation, we have future contingent payment obligations of up to \$11.0 million and \$1.8 million in cash, respectively, based upon the achievement of certain operational targets. As of June 30, 2008, we are uncertain if the operational targets for the earnouts will be achieved, and as such no compensation expense or purchase price has been recorded in connection with these contingent payment obligations. We will continue to re-assess the probability of achievement of the operational targets on a quarterly basis. For further information see Note 3 included in our Annual Report on Form 10-K for the year ended December 31, 2007.

Reductions in interest rates could materially impact our interest income and may negatively impact future reported operating results and earnings per share.

The following table sets forth the cash flow components for the following periods (in thousands):

|  | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2008</b>                          | <b>2007</b> |

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|                                                     |             |             |
|-----------------------------------------------------|-------------|-------------|
| Net cash provided by operating activities           | \$ 24,296   | \$ 20,538   |
| Net cash provided by (used in) investing activities | \$ 111,071  | \$ (38,356) |
| Net cash (used in) provided by financing activities | \$ (17,504) | \$ 3,767    |

***Operating Activities***

Net cash provided by operating activities of \$24.3 million for the six months ended June 30, 2008 was primarily attributable to net income of \$5.4 million, which includes depreciation and amortization of \$20.2 million, amortization of stock-based compensation of \$7.0 million, an increase to the provision for doubtful accounts and sales credits of \$3.6 million, and an increase to deferred revenue and other current liabilities of \$1.5 million, partially offset by decreases in accounts payable and accrued expenses of \$6.5 million, a deferred tax benefit of \$1.1 million, a stock-based compensation windfall tax benefit of \$0.3 million, an increase in prepaid expenses and other current assets of \$1.8 million, and an increase in accounts receivable of \$4.2 million due to an overall increase in revenue. Net cash provided by operating activities of \$20.5 million for the six months ended June 30, 2007 was primarily attributable to net income of \$11.1 million, which includes depreciation and amortization of \$16.9 million, amortization of stock-based compensation of \$4.6 million, an increase to the provision for doubtful accounts and sales credits of \$2.4 million, and an increase to deferred revenue and other current liabilities of \$1.0 million, partially offset by a deferred tax benefit of \$3.1 million, a stock-based compensation windfall tax benefit of \$1.7 million, an increase in accounts receivable of \$8.2 million due to an overall increase in revenue, and a decrease in accounts payable and accrued expenses of \$3.6 million.

**Table of Contents*****Investing Activities***

Net cash provided by investing activities of \$111.1 million for the six months ended June 30, 2008 was primarily attributable to the net sale of investments of \$120.8 million offset by capital expenditures of \$3.0 million, an increase in capitalized software and web site development costs of \$4.4 million, and the payment for net assets acquired of \$2.4 million. Net cash used in investing activities of \$38.4 million for the six months ended June 30, 2007 was attributable to capital expenditures of \$3.0 million, an increase in capitalized software and website development costs of \$2.1 million, and payments for net assets acquired of \$99.4 million, offset by the net sale of short-term investments of \$66.1 million.

***Financing Activities***

Net cash used in financing activities of \$17.5 million for the six months ended June 30, 2008 was primarily attributable to the repurchase of 1.0 million shares of common stock for an aggregate price of approximately \$19.1 million, offset by the net proceeds received from employee stock purchases under our employee stock purchase plan of \$1.1 million and the exercise of employee stock options of \$0.8 million. Net cash provided by financing activities of \$3.8 million for the six months ended June 30, 2007 was attributable to the receipt of cash proceeds from the exercise of employee stock options of \$1.6 million, net proceeds received from employee stock purchases under our employee stock purchase plan of \$0.8 million, and stock-based compensation windfall tax benefit of \$1.7 million.

**Contractual Obligations**

As of June 30, 2008, there were no material changes in our contractual obligations as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007 except for our \$0.3 million inventory purchase commitment disclosed as of March 31, 2008 which has been resolved as of June 30, 2008.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

**Industry Trends**

The number of dealers serviced and the level of indirect financing and leasing by our participating financing source customers, special promotions by automobile manufacturers and the level of indirect financing and leasing by captive finance companies not available in our network impact our business. Our business may be affected by these and other economical, seasonal and promotional trends in the indirect automotive finance market.

**Effects of Inflation**

Our monetary assets, consisting primarily of cash and cash equivalents, receivables and long-term investments, and our non-monetary assets, consisting primarily of intangible assets and goodwill, are not affected significantly by inflation. We believe that replacement costs of equipment, furniture and leasehold improvements will not materially affect our operations. However, the rate of inflation affects our expenses, which may not be readily recoverable in the prices of products and services we offer.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk*****Foreign Currency Exposure**

We only have operations located in, and provide services to, customers in the United States and Canada. Our earnings are affected by fluctuations in the value of the U.S. dollar as compared with the Canadian dollar. Our exposure is mitigated, in part, by the fact that we incur certain operating costs in the same foreign currency in which revenue is denominated. The foreign currency exposure that does exist is limited by the fact that the majority of transactions are paid according to our standard payment terms, which are generally short-term in nature.

**Interest Rate Exposure**

As of June 30, 2008, we had cash, cash equivalents, short-term investments and non-current investments of \$216.2 million invested in money market instruments, corporate bonds, municipal commercial paper, and tax-exempt auction rate securities and tax advantaged preferred stock trust securities. Such investments are subject to interest rate and credit risk. Our policy of investing in securities with original maturities of three months or less minimizes our interest and credit risk.

As of June 30, 2008, approximately \$12.8 million of our investment portfolio consisted primarily of state and local government, universities and preferred stock trust securities. If the issuers of these securities are unable to successfully complete future auctions or refinance their obligations and their credit ratings deteriorate, we may be required to adjust the carrying value of these securities and recognize an impairment charge for an other-than-temporary decline in fair value. As of June 30, 2008, we have \$0.5 million in unrealized losses. We believe that we will be able to liquidate our investment without material loss and that these securities are not permanently impaired, however due to the uncertainty of whether we will be able to sell these securities within the next year, we have reclassified them to long-term at June 30, 2008. Based on our available cash and other investments, we do not currently anticipate the lack of liquidity caused by failed auctions, if any, related to these securities will have a material adverse effect on our operating cash flows or will affect our ability to operate our business as usual.

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**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

We carried out an evaluation under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. In designing and evaluating our disclosure controls and procedures, we and our management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that they believe that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are a party to litigation matters arising in connection with the normal course of our 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. RouteOne LLC**

On January 28, 2004, we filed a Complaint and Demand for Jury Trial against RouteOne LLC (RouteOne) in the United States District Court for the Eastern District of New York, Civil Action No. CV 04-322 (SJF). The complaint sought injunctive relief as well as damages against RouteOne for infringement of two patents owned by us, which relate to computer implemented automated credit application analysis and decision routing inventions (the Patents). The complaint also sought relief for RouteOne's acts of copyright infringement, circumvention of technological measures and common law fraud and unfair competition.

The court approved a joint stipulation of dismissal with respect to this action. Pursuant to the joint stipulation, the patent count has been dismissed without prejudice to be pursued as part of the below consolidated actions and all other counts have been dismissed with prejudice.

**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 seeks declaratory and injunctive relief, as well as, damages against the defendants for infringement of the Patents. We also are seeking relief for acts of copyright infringement and unfair competition.

On June 8, 2006, David Huber and Finance Express filed their answer and counterclaims. The counterclaims seek damages for libel related to an allegation in the complaint, breach of contract, deceit, actual and constructive fraud, misappropriation of trade secrets and unfair competition related to a confidentiality agreement between the parties. On October 26, 2006, the Court dismissed the counterclaim for libel pursuant to a motion by us.

On October 27, 2006, 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-06-6864 (SJF). The complaint seeks declaratory and injunctive relief as well as damages against the defendants for infringement of the Patents. On November 28, 2006 and December 4, 2006, respectively, defendants RouteOne, David Huber and Finance Express filed their answers. Finance Express also asserted counterclaims for breach of contract, deceit, actual and constructive fraud, misappropriation of trade secrets and unfair competition related to a confidentiality agreement between Finance Express and us.



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 seeks declaratory and injunctive relief as well as damages against the defendants for infringement of U. S. Pat. 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. RouteOne, David Huber and Finance Express asserted counterclaims for a declaratory judgment of unenforceability due to inequitable conduct with respect to the 427 Patent and the Patents. David Huber and Finance Express also asserted counterclaims for breach of contract, deceit, actual and constructive fraud, misappropriation of trade secrets and unfair competition related to a confidentiality agreement between Finance Express and us.

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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, have been 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 are completed, as well as motions for summary judgment.

On July 21, 2008, the court resolved disputed issues of inventorship, validity, inequitable conduct, and RouteOne's exposure to a willful infringement claim, in our favor. These rulings eliminate certain defenses by RouteOne and Finance Express and allow our damages to be trebled if RouteOne's infringement is found to be willful at trial.

A decision in the Markman hearing has not yet been issued. The court deferred rulings on two additional summary judgment motions pending its upcoming Markman ruling, in which the court will decide the meaning of certain terms in the patent claims. The court also denied our motion to remove one defense, reserving it for trial because of questions of fact.

The parties are preparing for the trial that is currently scheduled to begin on October 28, 2008.

We intend to pursue our claims and defend any counterclaims vigorously.

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

**Item 1A. Risk Factors**

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in the section entitled Risk Factors in Part I, Item 1A. of our Annual Report on Form 10-K for the year ended December 31, 2007, which was filed with the SEC on February 28, 2008, that could materially affect our business, financial condition or results of operations. The risks described in that Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition and/or results of operations. There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**  
**Purchases of Equity Securities by the Issuer**

From time to time, in connection with the vesting of restricted common stock under our Amended and Restated 2005 Incentive Award Plan, we may receive shares of our common stock from certain restricted common stockholders in consideration of the tax withholdings due upon the vesting of restricted common stock. Additionally, on March 18, 2008, the board of directors authorized a stock repurchase programs under which we may spend up to \$75.0 million to repurchase our common stock. Stock repurchases under this program may be made on the open market, through 10b5-1 programs, or in privately negotiated transactions in accordance with all applicable laws, rules and regulations. The transactions may be made from time to time without prior notice and in such amounts as management deems appropriate and will be funded from cash on hand. The number of shares to be repurchased and the timing of repurchases will be based on several factors, including the price of our common stock, legal or regulatory requirements, general business and market conditions, and other investment opportunities. The stock repurchase program will expire on March 31, 2009, but may be limited or terminated at any time by the Board of Directors without prior notice. During the first six months of 2008, we repurchased approximately 1.0 million shares of our common stock pursuant to the repurchase program for an aggregate price of approximately \$19.1 million.

The following table sets forth the repurchases for the three months ended June 30, 2008:

| <b>Total<br/>Number of<br/>Shares<br/>Purchased<br/><br/>as Part of<br/>Publicly</b> | <b>Maximum<br/>Number<br/>of Shares<br/>That<br/>May Yet<br/>be<br/>Purchased</b> |
|--------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|
|--------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|

| <b>Period</b> | <b>Total<br/>Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid per<br/>Share</b> | <b>Announced<br/>Program</b> | <b>Under the<br/>Program</b> |
|---------------|-----------------------------------------------------|-------------------------------------------------|------------------------------|------------------------------|
| April 2008    |                                                     | \$                                              | n/a                          | n/a                          |
| May 2008      | 403                                                 | \$ 19.22                                        | n/a                          | n/a                          |
| June 2008     | 994,284                                             | \$ 19.18                                        | 994,284                      | (1)                          |
| Total         | 994,687                                             |                                                 |                              |                              |

(1) As of June 30, 2008, an additional \$55.9 million of our common stock may still be purchased under the repurchase program.

**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders**

The 2008 Annual Meeting of Stockholders of DealerTrack Holdings, Inc. was held on June 3, 2008. A total of 40,104,045 shares of common stock were present or represented by proxy at the meeting. This represented 94.2% of the total shares outstanding. The following matters were voted on and approved:

1. The individuals named below were elected as a Class III Directors to a three-year term expiring at our annual meeting of stockholders in 2011 or until his or her earlier resignation or removal:

| Name                  | Votes Received | Votes Withheld |
|-----------------------|----------------|----------------|
| Mary Cirillo-Goldberg | 34,881,187     | 5,222,858      |
| Mark F. O Neil        | 35,031,615     | 5,072,430      |

No other persons were nominated, nor received votes, for election as a director of the Company at the 2008 annual meeting. The other directors of the Company whose terms continued after the 2008 Annual Meeting were Ann B. Lane, John J. McDonnell, James David Power III, Howard L. Tischler and Barry Zwarenstein.

2. The stockholders ratified the selection of PricewaterhouseCoopers LLP as DealerTrack's independent registered public accounting firm for the fiscal year ending December 31, 2008. The votes cast at the 2008 annual meeting were as follows: 40,084,265 shares voted for, 19,522 voted against and 258 abstained from voting. There were no broker non-votes with respect to this proposal.

3. The stockholders approved the amendment and restatement of Amended and Restated DealerTrack Holdings, Inc. 2005 Incentive Plan. The votes cast at the 2008 annual meeting were as follows: 31,443,034 shares voted for, 5,977,021 voted against and 10,120 shares abstained from voting. There were 2,673,870 broker non-votes with respect to this proposal.

**Item 6. Exhibits****Exhibit Number****Description of Document**

- |      |                                                                                                                                                                                                                                                                                  |
|------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1 | Second Amended and Restated DealerTrack Holdings, Inc. 2005 Incentive Award Plan (incorporated by reference to Exhibit I to the Company's definitive proxy statement filed on April 29, 2008).                                                                                   |
| 31.1 | Certification of Mark F. O Neil, Chairman, President and Chief Executive Officer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                |
| 31.2 | Certification of Robert J. Cox III, Senior Vice President, Chief Financial Officer and Treasurer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                |
| 32.1 | Certifications of Mark F. O Neil, Chairman, President and Chief Executive Officer, and Robert J. Cox III, Senior Vice President, Chief Financial Officer and Treasurer, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DealerTrack Holdings, Inc.  
(Registrant)

Date: August 11, 2008

/s/ Robert J. Cox III  
Robert J. Cox III

Senior Vice President, Chief Financial  
Officer and Treasurer  
(Principal Financial and Accounting  
Officer)

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**EXHIBIT INDEX**

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