AUTOBYTEL INC

FORM 10-Q
(Quarterly Report)

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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 September 30, 2005

or

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

For the transition period from ___________to ___________.

Commission file number 0-22239

Autobytel Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**33-0711569** **(I.R.S. Employer identification number)**
18872 MacArthur Boulevard, Irvine, California **(Address of principal executive offices)**	**92612** **(Zip Code)**

(949) 225-4500
(Registrant's telephone number, including area code)

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

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 October 31, 2005, there were 42,007,889 shares of the Registrant's Common Stock outstanding.

Table of Contents

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. ***Consolidated Financial Statements***

AUTOBYTEL INC.

CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share and per share data)
(unaudited)

	September 30, 2005	December 31, 2004
ASSETS		
Current assets:		
Domestic cash and cash equivalents	$ 29,149	$ 24,287
Restricted international cash and cash equivalents	8,498	9,053
Short-term investments	9,000	16,500
Accounts receivable, net of allowances for bad debts and customer credits of $1,246 and $1,037, respectively	19,426	17,920
Prepaid expenses and other current assets	3,325	2,344
Total current assets	69,398	70,104
Long-term investments	6,000	12,000
Property and equipment, net	4,169	3,389
Capitalized internal use software, net	95	225
Goodwill	70,697	70,697
Acquired intangible assets, net	2,651	4,187
Other assets	98	115
Total assets	$ 153,108	$ 160,717
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,205	$ 5,812
Accrued expenses	7,696	7,990
Current portion of deferred revenues	4,122	4,029
Accrued domestic restructuring	—	74
Other current liabilities	2,234	2,216
Total current liabilities	19,257	20,121
Long-term deferred revenues	—	8
Total liabilities	19,257	20,129
Minority interest	4,247	4,521
Commitments and contingencies (Note 6.)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 11,445,187 shares authorized; none outstanding	—	—
Common stock, $0.001 par value; 200,000,000 shares authorized; 42,007,889 and 41,905,848 shares issued and outstanding, respectively	42	42
Additional paid-in capital	282,605	282,287
Accumulated other comprehensive income	1,698	2,099
Accumulated deficit	(154,741)	(148,361)
Total stockholders' equity	129,604	136,067
Total liabilities, minority interest and stockholders' equity	$ 153,108	$ 160,717

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

Table of Contents

AUTOBYTEL INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(Amounts in thousands, except share and per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues	$ 30,595	$ 32,453	$ 95,308	$ 88,193
Costs and expenses:				
Cost of revenues	12,811	13,049	38,880	36,465
Sales and marketing	6,069	6,333	21,159	19,416
Product and technology development	5,713	5,115	18,063	14,925
General and administrative	6,476	4,411	23,343	11,944
Amortization of acquired intangible assets	370	451	1,184	782
Total costs and expenses	31,439	29,359	102,629	83,532
Income (loss) from operations	(844)	3,094	(7,321)	4,661
Interest income	401	244	1,139	649
Loss in equity investee	—	—	—	(84)
Foreign currency exchange gain	11	—	21	20
Other expense	—	(10)	—	(9)
Minority interest	—	(27)	(93)	(74)
Income (loss) before income taxes	(432)	3,301	(6,254)	5,163
Benefit (provision) for income taxes	145	(92)	(126)	(292)
Net income (loss)	$ (287)	$ 3,209	$ (6,380)	$ 4,871
Net income (loss) per share:				
Basic	$ (0.01)	$ 0.08	$ (0.15)	$ 0.12
Diluted	$ (0.01)	$ 0.07	$ (0.15)	$ 0.11
Shares used in computing net income (loss) per share:				
Basic	41,955,016	41,757,703	41,922,751	40,413,342
Diluted	41,955,016	44,300,265	41,922,751	43,917,425
Comprehensive income (loss):				
Net income (loss)	$ (287)	$ 3,209	$ (6,380)	$ 4,871
Translation adjustment	(87)	(61)	(401)	6
Comprehensive income (loss)	$ (374)	$ 3,148	$ (6,781)	$ 4,877

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

AUTOBYTEL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)
(unaudited)

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Cash flows from operating activities:		
Net income (loss)	$ (6,380)	$ 4,871
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Non-cash charges:		
Depreciation and amortization	1,315	1,216
Amortization of capitalized internal use software	202	685
Amortization of acquired intangible assets	1,432	923
Impairment of acquired intangible assets	104	173
Provision for bad debt	621	154
Provision for customer credits	2,330	1,231
Loss (gain) on disposal of property and equipment	(10)	20
Loss in equity investee	—	84
Minority interest	93	74
Changes in assets and liabilities, excluding the effect of acquisitions and consolidation of Autobytel.Europe:		
Accounts receivable	(4,457)	(2,240)
Prepaid expenses and other current assets	(981)	(477)
Other assets	17	17
Accounts payable	(607)	(395)
Accrued expenses	(294)	(973)
Deferred revenues	85	(616)
Accrued domestic restructuring	(74)	(137)
Accrued international licensee liabilities	—	(1,541)
Other current liabilities	18	236
Net cash provided by (used in) operating activities	(6,586)	3,305
Cash flows from investing activities:		
Acquisitions of businesses, net of cash acquired	—	(20,631)
Sales and maturities of short-term and long-term investments	21,600	17,991
Purchases of short-term and long-term investments	(8,100)	(42,500)
Redemptions of long-term investments	—	12,000
Changes in restricted international cash and cash equivalents	(213)	2,005
Capitalized internal use software costs	(72)	—
Purchases of property and equipment	(2,177)	(1,449)
Proceeds from sale of property and equipment	92	—
Net cash provided by (used in) investing activities	11,130	(32,584)
Cash flows from financing activities:		
Payments of capital lease obligations	—	(225)
Net proceeds from sale of common stock	318	3,994
Net cash provided by financing activities	318	3,769
Net increase (decrease) in cash and cash equivalents	4,862	(25,510)
Cash and cash equivalents, beginning of period	24,287	45,643
Cash and cash equivalents, end of period	$29,149	$ 20,133
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	$ 588	$ 84

Cash paid during the period for interest	$ —	$ 9

Supplemental disclosure of non-cash investing activities:

- In March 2004, Autobytel consolidated Autobytel.Europe due to the adoption of FIN 46R. As a result of this adoption, Autobytel recorded $10,459 in assets (including $10,425 of restricted international cash and cash equivalents), $2,300 in liabilities and $4,161 in minority interest. (See Note 3.)

AUTOBYTEL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)
(unaudited)

- In April 2004, in conjunction with the acquisition of iDriveonline, Inc., tangible and intangible assets of $12,672 were acquired, liabilities of $770 were assumed and 474,501 shares of common stock valued at $6,775 were issued. (See Note 4.)
- In April 2004, in conjunction with the acquisition of Stoneage Corporation, tangible and intangible assets of $53,715 were acquired (including $149 of property and equipment acquired under capital leases), liabilities of $3,547 were assumed and 2,257,733 shares of common stock valued at $33,770 were issued. Additionally, based on the determination of the Stoneage Corporation final purchase price allocation, 47,511 additional shares of common stock valued at $710 were issued in July 2004. (See Note 4.)

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

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share data)
(unaudited)

1. Organization and Operations of Autobytel

Autobytel Inc. (Autobytel) is an automotive marketing services company that helps dealers sell cars and manufacturers build brands through efficient marketing and advertising primarily through the Internet. Autobytel provides products and programs to automotive dealers and manufacturers to help them increase marketing efficiency and reduce customer acquisition costs. Autobytel owns and operates the automotive Web sites Autobytel.com, Autoweb.com, Car.com, CarSmart.com, Autosite.com, AICAutoSite.com, Autoahorros.com and CarTV.com. Autobytel is also a leading provider of customer relationship management (CRM) products and programs, which consist of lead management products, customer loyalty and retention marketing programs, and data extraction services for dealers. Autobytel is also a provider of automotive marketing data and technology.

Autobytel is a Delaware corporation incorporated on May 17, 1996. Its principal corporate offices are located in Irvine, California. Autobytel completed an initial public offering in March 1999 and its common stock is listed on the Nasdaq National Market under the symbol ABTL.

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Statements

The accompanying interim consolidated financial statements as of September 30, 2005, and for the three months and nine months ended September 30, 2005 and 2004 are unaudited. The unaudited interim consolidated financial statements have been prepared on the same basis as the audited annual consolidated financial statements and, in the opinion of Autobytel’s management, reflect all adjustments, which are of a normal recurring nature, necessary to fairly state Autobytel’s consolidated balance sheets and statements of operations and cash flows for the periods presented in accordance with accounting principles generally accepted in the United States. Autobytel’s results for an interim period are not necessarily indicative of the results that may be expected for the year.

Although Autobytel believes that all adjustments necessary for a fair presentation of the interim periods presented are included and that the disclosures are adequate, these consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements and related notes for the year ended December 31, 2004 included in Autobytel’s Annual Report on Form 10-K, filed with the Securities and Exchange Commission (SEC) on May 31, 2005.

Principles of Consolidation

On March 31, 2004, Autobytel adopted FIN 46R and determined it was the primary beneficiary of Autobytel.Europe LLC (Autobytel.Europe). As a result of adopting FIN 46R, Autobytel consolidated Autobytel.Europe in its consolidated financial statements. Autobytel owns 49% of Autobytel.Europe. (See Note 3.)

All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires Autobytel to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the consolidated balance sheets and the consolidated statements of cash flows, Autobytel considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. Domestic cash and cash equivalents represent amounts held by Autobytel for use by Autobytel.

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
(unaudited)

Restricted International Cash and Cash Equivalents

Restricted international cash and cash equivalents represent amounts held for Autobytel.Europe's current operations use as directed by Autobytel.Europe. Restricted international cash and cash equivalents are not available to Autobytel.

Short-Term and Long-Term Investments

Autobytel categorized its debt securities as either held-to-maturity or available-for-sale investments in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." All held-to-maturity securities with remaining maturities of less than one year are classified as short-term investments and all held-to-maturity securities with remaining maturities greater than one year are classified as long-term investments and are reported at amortized cost. Autobytel categorized auction rate securities as available-for-sale short-term investments. Auction rate securities are reported at cost, which approximates fair market value due to the interest rate reset feature of these securities. As such, no unrealized gains or losses related to these securities were recognized during the three months ended September 30, 2004 and nine months ended September 30, 2005 and 2004. The cost of securities sold is based on the specific identification method.

The longer the term of the securities, the more susceptible they are to changes in market rates of interest and yields on bonds. Autobytel reviews its investments in debt securities for potential impairment on a regular basis. As part of the evaluation process, Autobytel reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and Autobytel's intent and ability to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. Autobytel has the intent and ability to hold these securities for a reasonable period of time sufficient for a forecasted recovery of fair value up to the initial cost of the investment. Autobytel expects to realize the full value of all of these investments upon maturity. Autobytel will record an impairment loss on investments for any other-than-temporary decline in fair value of these debt securities below their cost basis. For the three months and nine months ended September 30, 2005 and 2004, Autobytel did not record any impairment losses that were related to other-than-temporary decline in fair value of its debt securities.

As of September 30, 2005 and December 31, 2004, the amortized cost basis, aggregate fair value, unrealized gains and losses by security type were as follows:

	Amortized Cost Basis	Aggregate Fair Value	Unrealized Gains	Unrealized Losses
September 30, 2005:				
Short-term investments, held-to-maturity:				
Government sponsored agency bonds	$ 9,000	$ 8,900	$ —	$ 100
Long-term investments, held-to-maturity:				
Government sponsored agency bonds	6,000	5,931	—	69
Total as of September 30, 2005	$ 15,000	$ 14,831	$ —	$ 169
December 31, 2004:				
Short-term investments, available for sale:				
Auction rate securities	$ 10,500	$ 10,500	$ —	$ —
Short-term investments, held-to-maturity:				
Government sponsored agency bonds	6,000	5,976	—	24
	16,500	16,476	—	24
Long-term investments, held-to-maturity:				
Government sponsored agency bonds	12,000	11,905	—	95
Total as of December 31, 2004	$ 28,500	$ 28,381	$ —	$ 119

The following represents the contractual maturities of investments as of September 30, 2005:

	Amortized Cost Basis
Due within one year	$ 9,000
Due after one through two years	6,000

$ 15,000

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
(unaudited)

Revenues

Autobytel classifies revenues as lead fees, advertising, customer relationship management (CRM) services, and data, applications and other. Revenues by groups of similar services are as follows for the three months and nine months ended September 30, 2005 and 2004:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Lead fees	$18,560	$22,414	$59,884	$61,378
Advertising	4,832	3,551	14,090	9,818
CRM services	6,151	5,382	17,949	13,342
Data, applications and other	1,052	1,106	3,385	3,655
Total revenues	$30,595	$32,453	$95,308	$88,193

Computation of Basic and Diluted Net Income (Loss) per share

Net income (loss) per share has been calculated under SFAS No. 128, “Earnings per Share.” SFAS No. 128 requires companies to compute earnings per share under two different methods, basic and diluted. Basic net income (loss) per share is calculated by dividing the net income by the weighted average shares of common stock outstanding during the period. Diluted net income (loss) per share is calculated by dividing the net income by the weighted average shares of common stock outstanding during the period and dilutive potential shares of common stock. Dilutive potential shares of common stock, as determined under the treasury stock method, consist of shares of common stock issuable upon exercise of stock options net of shares of common stock assumed to be repurchased by Autobytel from the exercise proceeds.

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Numerator:				
Net income (loss)	$ (287)	$ 3,209	$ (6,380)	$ 4,871
Denominator:				
Weighted average common shares and denominator for basic calculation	41,955,016	41,757,703	41,922,751	40,413,342
Weighted average effect of dilutive securities:				
Employee stock options	—	2,542,562	—	3,504,083
Denominator for diluted calculation	41,955,016	44,300,265	41,922,751	43,917,425
Net income (loss) per share—basic	$ (0.01)	$ 0.08	$ (0.15)	$ 0.12
Net income (loss) per share—diluted	$ (0.01)	$ 0.07	$ (0.15)	$ 0.11

For the three months and nine months ended September 30, 2005, 5,975,840 and 6,094,129, respectively, antidilutive potential shares of common stock, consisting of employee stock options and employee stock purchase plan, have been excluded from the calculation of diluted net income (loss) per share, as Autobytel incurred a net loss for the period. For the three months and nine months ended September 30, 2004, 1,399,338 and 2,496,555, respectively, antidilutive potential shares of common stock have been excluded from the calculation of diluted net income per share which represent stock options with an exercise price greater than the average market price for the period.

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
(unaudited)

Stock-Based Compensation

As permitted under SFAS No. 148, “Accounting for Stock-Based Compensation-Transition and Disclosure,” which amended SFAS No. 123, “Accounting for Stock-Based Compensation”, Autobytel has elected to continue to account for its stock-based compensation using the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion (APB) No. 25, “Accounting for Stock Issued to Employees.” Under APB 25, compensation expense is recognized over the vesting period based on the excess of the market closing price over the exercise price on the grant date.

For disclosure purposes, stock compensation expense has been estimated using the Black-Scholes option-pricing model on the date of grant and assumptions related to dividend yield, stock price volatility, weighted-average risk free interest rate and expected life of the stock options, which is a fair value based method. Had the provisions of SFAS No. 123 been applied to Autobytel’s stock option grants for its stock-based compensation plans, Autobytel’s net income (loss) and net income (loss) per share for the three months and nine months ended September 30, 2005 and 2004, would approximate the pro forma amounts below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss):				
As reported	$ (287)	$ 3,209	$ (6,380)	$ 4,871
Less: Employee stock-based compensation determined under the fair value based method	(2,157)	(1,476)	(5,036)	(4,248)
Pro forma net income (loss)	$(2,444)	$ 1,733	$(11,416)	$ 623
Net income (loss) per share—basic:				
As reported	$ (0.01)	$ 0.08	$ (0.15)	$ 0.12
Pro forma	$ (0.06)	$ 0.04	$ (0.27)	$ 0.02
Net income (loss) per share—diluted:				
As reported	$ (0.01)	$ 0.07	$ (0.15)	$ 0.11
Pro forma	$ (0.06)	$ 0.04	$ (0.27)	$ 0.01

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts.

Autobytel granted 749,000 and 805,000 stock options to employees and directors during the three months ended September 30, 2005 and 2004, respectively. Autobytel granted 1,642,500 and 1,793,000 stock options to employees and directors during the nine months ended September 30, 2005 and 2004, respectively. The options granted in the three months ended September 30, 2005 and 2004 were estimated to have a weighted average fair value per share of $2.39 and $4.45, respectively. The options granted in the nine months ended September 30, 2005 and 2004 were estimated to have a weighted average fair value per share of $2.49 and $5.51, respectively. The fair value was based on the Black-Scholes option-pricing model on the date of grant and the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Dividend yield	— %	— %	— %	— %
Volatility	70.67%	70.43%	71.36%	68.08%
Weighted-average risk-free interest rate	4.031%	2.792%	3.824%	2.544%
Weighted-average expected life	3.5 years	3.5 years	3.5 years	3.5 years

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
(unaudited)

Awards issued under the employee stock purchase plan were estimated to have a weighted average fair value per award of $1.42 and $2.33 for the three months ended September 30, 2005 and 2004, respectively. Awards issued under the employee stock purchase plan were estimated to have a weighted average fair value per award of $1.18 and $2.33 for the nine months ended September 30, 2005 and 2004, respectively. The fair value was based on the Black-Scholes option-pricing model and the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Dividend yield	— %	— %	— %	— %
Volatility	44.95% - 77.97%	73.86%	44.95% - 77.97%	66.06% -73.86%
Risk-free interest rate	2.99% - 3.69%	1.03%	2.99% - 3.69%	1.03% -1.05%
Expected life	6 months	6 months	6 months	6 months

As of September 30, 2005, Autobytel had a total of 8,854,616 stock options outstanding, of which 4,686,720 stock options had exercise prices below the closing price per share of Autobytel's common stock on that date.

Business Segment

Autobytel conducts its business within one business segment, which is defined as providing automotive marketing services.

New Accounting Pronouncements

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 123R (revised 2004), "Share-Based Payment", which revised SFAS No. 123, "Accounting for Stock-Based Compensation". This statement supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". The revised statement addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the ability to account for share-based compensation transactions using APB 25 and requires that the compensation costs relating to such transactions be recognized in the consolidated statement of operations. The revised statement is effective as of the first annual period beginning after June 15, 2005. In accordance with the revised statement, Autobytel will be required to recognize the expense attributable to stock options granted or vested subsequent to December 31, 2005. Autobytel expects the adoption of SFAS 123R will result in amounts that are similar to the current pro forma disclosures in Note 2 of the Notes to Consolidated Financial Statements.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets, an amendment of APB Opinion No. 29," ("SFAS 153"). SFAS 153 addresses the measurement of exchanges of non-monetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS 153 is effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS 153 is not expected to have a material effect on Autobytel's consolidated financial position or results of operations.

On March 29, 2005, the SEC issued Staff Accounting Bulletin ("SAB") 107 which expresses the views of the SEC regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provides the SEC's views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB 107 provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management's Discussion and Analysis of Financial Condition and Results of Operations subsequent to adoption of SFAS No. 123R. Autobytel does not expect the impact of SAB 107, which became effective on March 29, 2005, to have a material impact on its consolidated financial position, results of operations or cash flows.

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
(unaudited)

In May 2005, Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 154, "Accounting Changes and Error Corrections " ("SFAS 154"). SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle. It also requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. The statement will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Autobytel does not expect the adoption of SFAS 154 to have a material effect on its consolidated financial position or results of operations.

3. Autobytel.Europe LLC

Autobytel.Europe was organized in August 1997 and began operations in the fourth quarter of 1999. Autobytel.Europe was formed to expand the Autobytel business model and operations throughout Europe.

On March 28, 2002, Autobytel.Europe completed a recapitalization, which reduced Autobytel's ownership of Autobytel.Europe from 76.5% to 49%. As a result of the reduction in Autobytel's ownership interest, Autobytel accounted for its investment in Autobytel.Europe under the equity method subsequent to March 28, 2002.

On March 31, 2004, Autobytel adopted the provisions of FIN 46R and determined it was the primary beneficiary of Autobytel.Europe. The assets and liabilities of Autobytel.Europe were as follows:

	As of	
	September 30, 2005	December 31, 2004
Restricted international cash and cash equivalents	$ 8,498	$ 9,053
Other current and non-current assets	19	75
Current liabilities	(189)	(264)
Minority interest	(4,247)	(4,521)
	$ 4,081	$ 4,343

Autobytel.Europe's revenue and expenses are included in Autobytel's consolidated results of operations beginning April 1, 2004. Autobytel.Europe's revenue for the three months and nine months ended September 30, 2005 was $136 and $212, respectively, and for the three and nine months ended September 30, 2004 was $21 and $56, respectively.

4. Acquisitions

Acquisition of Stoneage Corporation

On April 15, 2004, Autobytel acquired all of the outstanding common stock of Stoneage Corporation (Stoneage), now Car.com, Inc., a provider of Internet automotive buying services and owner of the Car.com Web site. Stoneage was acquired with the intention to expand Autobytel's market share of new car buyers, increase the number of purchase requests processed through Autobytel, and add retail and enterprise dealer relationships to Autobytel. The acquisition also added the Car.com finance request business to Autobytel. Autobytel believes that the combined assets will further position it as a leader in the internet automotive business services sector. The aggregate purchase price was $50,767 and consisted of $15,251 in cash and 2,305,244 shares of common stock valued at $34,480 and transaction costs of $1,036.

Stoneage's financial position and results of operations from the date of acquisition on April 15, 2004 have been included in the accompanying consolidated financial statements.

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
(unaudited)

Acquisition of iDriveonline, Inc.

On April 9, 2004, Autobytel acquired all of the outstanding common stock of iDriveonline, Inc. (iDriveonline), now Retention Performance Marketing, Inc., a provider of customer loyalty and retention marketing programs for the automotive industry, in exchange for cash and common stock. The acquisition combines iDriveonline's leading applications, including an online prospecting and retention tool, enhanced data and segmentation tools, and improved dealer reporting capabilities with Autobytel's existing customer retention program. Through this acquisition, Autobytel gained a meaningful presence in the automotive CRM marketplace. The aggregate purchase price was $12,168 and consisted of $5,021 in cash, 474,501 shares of common stock valued at $6,775 and transaction costs of $372.

iDriveonline's financial position and results of operations from the date of acquisition on April 9, 2004 have been included in the accompanying consolidated financial statements.

Proforma Consolidated Results of Operations

The following summarized unaudited pro forma consolidated results of operations are presented as if the acquisitions of iDriveonline and Stoneage had occurred on January 1, 2004. The unaudited pro forma results are not necessarily indicative of future earnings or earnings that would have been reported had the acquisitions been completed as presented.

	Nine Months Ended September 30, 2004
Revenues	$ 97,582
Net income	$ 6,130
Net income per share:	
Basic	$ 0.15
Diluted	$ 0.14

5. Acquired Intangible Assets

Acquired intangible assets recorded as a part of the AVV, Inc., iDriveonline and Stoneage acquisitions are amortized over their estimated useful lives and consist of the following:

	As of September 30, 2005				
	Average Estimated Useful Lives	Gross Carrying Amount	Accumulated Amortization	Impairment Charge	Net Amount
Developed technology	2 years	$ 820	$ (604)	$ —	$ 216
Customer relationships	3 years	4,375	(2,132)	(304)	1,939
Domain name	5 years	700	(204)	—	496
Total		$ 5,895	$ (2,940)	$ (304)	$2,651

	As of December 31, 2004				
	Average Estimated Useful Lives	Gross Carrying Amount	Accumulated Amortization	Impairment Charge	Net Amount
Developed technology	2 years	$ 820	$ (289)	$ —	$ 531
Customer relationships	3 years	4,375	(1,120)	(200)	3,055
Domain name	5 years	700	(99)	—	601
Total		$ 5,895	$ (1,508)	$ (200)	$4,187

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
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Amortization expense for the remaining lives of the acquired intangible assets is estimated to be as follows:

	Amortization Expense
Three months ending December 31, 2005	$ 461
2006	$ 1,513
2007	$ 496
2008	$ 140
2009	$ 41

6. Commitments and Contingencies

Litigation

In August 2001, a purported class action lawsuit was filed in the United States District Court for the Southern District of New York against Autobytel and certain of Autobytel's current and former directors and officers (the "Autobytel Individual Defendants") and underwriters involved in Autobytel's initial public offering. The complaints against Autobytel have been consolidated with two other complaints that relate to its initial public offering but do not name it as a defendant, and a Consolidated Amended Complaint, which is now the operative complaint, was filed on April 19, 2002. This action purports to allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Plaintiffs allege that the underwriter defendants agreed to allocate stock in Autobytel's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for Autobytel's initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The action seeks damages in an unspecified amount. The action is being coordinated with approximately 300 other nearly identical actions filed against other companies. A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Autobytel Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Autobytel Individual Defendants. On February 19, 2003, the Court denied the motion to dismiss the complaint against Autobytel. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Autobytel case. Autobytel has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autobytel, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of Autobytel and the Autobytel Individual Defendants for the conduct alleged in the action to be wrongful. Autobytel would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims Autobytel may have against its underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of Autobytel to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. Autobytel currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and Autobytel is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, Autobytel does not expect that the settlement will involve any payment by Autobytel. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from Autobytel's insurance carriers should arise, Autobytel's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and Autobytel is found liable, Autobytel is unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than its insurance coverage, or whether such damages would have a material impact on its results of operations, financial condition or cash flows in any future period.

Between April and June 2001, eight separate purported class actions virtually identical to the one filed against Autobytel were filed against Autoweb.com, Inc. ("Autoweb"), certain of Autoweb's current and former directors and officers

AUTOBYTEL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts in thousands, except per share data)
(unaudited)

(the "Autoweb Individual Defendants") and underwriters involved in Autoweb's initial public offering. The complaints against Autoweb have been consolidated into a single action, and a Consolidated Amended Complaint, which is now the operative complaint, was filed on April 19, 2002. The foregoing action purports to allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Plaintiffs allege that the underwriter defendants agreed to allocate stock in Autoweb's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for Autoweb's initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The action seeks damages in an unspecified amount. The action is being coordinated with approximately 300 other nearly identical actions filed against other companies. A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Autoweb Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Autoweb Individual Defendants. On February 19, 2003, the Court dismissed the Section 10(b) claim without prejudice and with leave to replead but denied the motion to dismiss the claim under Section 11 of the Securities Act of 1933 against Autoweb. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Autoweb case. Autoweb has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autoweb, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of Autoweb and the Autoweb Individual Defendants for the conduct alleged in the action to be wrongful. Autoweb would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims Autoweb may have against its underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of Autoweb to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. Autoweb currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and Autoweb is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, Autobytel does not expect that the settlement will involve any payment by Autoweb. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from Autoweb's insurance carriers should arise, Autoweb's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and Autoweb is found liable, Autobytel is unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than Autoweb's insurance coverage, or whether such damages would have a material impact on Autobytel's results of operations, financial condition or cash flows in any future period.

On September 24, 2004, Autobytel filed a lawsuit in the United States District Court for the Eastern District of Texas against Dealix Corporation. In that lawsuit, Autobytel asserted infringement of U.S. Patent No. 6,282,517, entitled "Real Time Communication of Purchase Requests," against Dealix Corporation. Autobytel contends that Dealix Corporation is infringing Autobytel's patent by virtue of Dealix Corporation's software system for the distribution of purchase requests and seeks damages and/or a preliminary injunction. Dealix Corporation filed answers to this lawsuit on January 28, 2005, February 1, 2005 and July 19, 2005, in which it asserts typical defensive counterclaims denying infringement, asserting patent misuse and challenging the validity of the patent. Autobytel filed a reply responding to such counterclaims on August 2, 2005. A Markman Hearing, to construe the individual terms of the asserted patent's claims prior to a determination of infringement, was held in October, 2005. Dealix Corporation also seeks attorney's fees and costs. Autobytel expects to incur attorneys' fees and costs in this matter as are customary in the prosecution of patent litigation, and could be liable for Dealix Corporation's attorneys' fees and costs if Dealix Corporation is successful in its counterclaims.

Between October and December 2004, five separate purported class actions were filed in the United States District Court for the Central District of California against Autobytel and certain of its current directors and current and former officers. The claims were brought on behalf of stockholders who purchased shares during the period July 24, 2003 through October 21, 2004. The claims alleged in all of these purported class actions were virtually identical, and purported to allege violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In this regard, the plaintiffs allege that Autobytel misrepresented and omitted material facts with respect to its financial results and operations during the time period between July 24, 2003 and October 20, 2004. The complaint sought unspecified compensatory damages, and attorneys' fees and costs, as well as accountants' and experts' fees. On January 28, 2005, the court ordered the consolidation of the currently pending class actions into a single case pursuant to a stipulation for consolidation signed by all parties. On March 14, 2005, the court appointed a lead plaintiff and approved the selection of lead counsel and liaison counsel. On June 30, 2005, the lead plaintiff filed and served a Consolidated Amended Class Action Complaint alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The putative class period is July 24, 2003 to October 21, 2004. Defendants filed and served a motion to dismiss the Consolidated Amended Class Action Complaint on August 1, 2005. The hearing is currently set for January 2006. Additional lawsuits asserting the same or similar claims may be filed as well. Autobytel intends to defend the claims vigorously. However, Autobytel cannot currently predict the impact or outcome of this litigation, which could be material, and the initiation, continuation and outcome of these lawsuits may have a material impact on Autobytel's results of operations, financial condition or cash flows.

In addition, Autobytel's directors and a former officer are defendants in a derivative suit pending in the Superior Court of Orange County, California, and Autobytel is named as a nominal defendant in this suit. This suit purports to allege that the defendants breached numerous duties to Autobytel, including breach of fiduciary duty and misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment, as well as violations of California Corporations Code 25402 (trading with material non-public information), and that these breaches and violations caused losses to Autobytel, including damages to its reputation and goodwill. Plaintiffs' claims are based on allegations that the defendants disseminated false and misleading statements concerning Autobytel's results of operations and that these results were inflated at all relevant times due to violations of generally accepted accounting principles and Securities and Exchange Commission rules. The complaint seeks unspecified compensatory damages, treble damages, equitable and/or injunctive relief, restitution, and attorneys' fees and costs, as well as accountants' and experts' fees. Plaintiffs filed and served an Amended Derivative Complaint on July 29, 2005. Defendants filed and served a motion to stay and a demurrer in October 2005. Autobytel intends to defend this suit vigorously. However, Autobytel cannot currently predict the impact or outcome of this litigation, which could be material, and the continuation and outcome of this lawsuit, as well as the initiation of similar suits may have a material impact on Autobytel's results of operations, financial condition or cash flows.

Autobytel has reviewed the above class and derivative actions and does not believe that it is probable that a loss contingency has occurred, therefore, no amounts have been recorded in the accompanying consolidated financial statements.

From time to time, Autobytel is involved in other litigation matters arising from the normal course of its business activities. The actions filed against Autobytel and other litigation, even if not meritorious, could result in substantial costs and diversion of resources and management attention and an adverse outcome in litigation could materially adversely affect Autobytel's business, results of operations, financial condition or cash flows.

7. Accrued Domestic Restructuring Liability

In 2002, Autobytel recorded a total of $769 for charges related to the restructuring of Autobytel's operations to reduce costs and enhance efficiencies. The charges included severance costs affecting approximately 15% of Autobytel's employees in sales, marketing and information technology, and Autobytel's lease obligation on the vacant portion of office facilities in Westborough, Massachusetts.

The remaining accrued domestic restructuring liabilities related to the 2002 restructuring charges for Autobytel's lease obligation on the vacant portion of office facilities in Westborough, Massachusetts were paid in full during the second quarter of 2005.

8. Related Party Transactions

Consulting Agreement

Autobytel and Robert Grimes, a current director and a former Executive Vice President of Autobytel, are parties to a consulting services agreement dated April 1, 2000. The agreement was extended through September 30, 2004 and then on a month to month basis until notice of termination by either party. During the term of the consulting agreement, Mr. Grimes will receive $50 per year payable on a monthly basis and a $2.5 monthly office expense allowance. These costs are included in product and technology development expenses in the consolidated statements of operations. Mr. Grimes will make himself available to the executive officers of Autobytel for up to 16 hours a month for consultation and other activities related to formulating and implementing business strategies and relationships. Autobytel may terminate the agreement upon Mr. Grimes' breach of contract. If Mr. Grimes' agreement is terminated without breach, Mr. Grimes is entitled to either a pro rated or a lump sum payment equal to the amount that would have been received by Mr. Grimes if he had remained a consultant for the remaining balance of the term. In the event of death or disability, Autobytel will pay to Mr. Grimes or his successors and assignees the amount that Mr. Grimes would have received for the remainder of the term of the agreement.

9. Subsequent Events

On October 21, 2005, Autobytel received a complaint as well as a demand for arbitration/statement of claim filed by certain former shareholders of Stoneage. The complaint was filed in the Central District of California and names Autobytel as well as certain current and former officers and directors as defendants. The demand for arbitration was filed with the American Arbitration Association and names the same group of defendants. The allegations and claims in both of these matters are virtually identical, and stem from the acquisition of Stoneage by Autobytel on April 15, 2004. Both the complaint and demand for arbitration contain causes of action for: breach of the acquisition agreement, breach of the registration rights agreement, violations of California Corporations Code Sections 25401 and 25501, violations of California Corporations Code Sections 25400 and 25500, fraud, negligent misrepresentation, fraudulent concealment, and violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The demand for arbitration also contains a cause of action for violation of Section 17(a) of the Securities Act of 1933. The complaint and demand for arbitration seek unspecified damages and attorneys' fees and costs, as well as rescission and punitive awards. The defendants have not responded to either the complaint or demand for arbitration. Autobytel intends to defend these claims vigorously. Autobytel cannot currently predict the outcome of this litigation, which, depending on the outcome, may have a material impact on Autobytel's results of operations, financial condition or cash flows.

On October 24, 2005, Autobytel announced that it retained the services of Merrill Lynch & Co. to assist Autobytel in exploring strategic alternatives, which may include potential acquisitions of, or mergers with, complementary businesses, as well as a potential sale of Autobytel.

Item 2. ***Management's Discussion And Analysis Of Financial Condition And Results Of Operations***

You should read the following discussion of our results of operations and financial condition in conjunction with our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements based on current expectations that involve risks and uncertainties. Actual results and the timing of certain events may differ significantly from those projected in such forward-looking statements due to a number of factors, including those discussed in the section entitled "Risk Factors" below in this Quarterly Report on Form 10-Q.

Overview

We are an automotive marketing services company that helps dealers sell cars and manufacturers build brands through efficient marketing and advertising primarily through the Internet. We own and operate the automotive Web sites Autobytel.com, Autoweb.com, Car.com, CarSmart.com, AutoSite.com, AICAutoSite.com, Autoahorros.com, and CarTV.com. We are also a leading provider of customer relationship management (CRM) products and programs, consisting of lead management products, customer loyalty and retention marketing programs, data extraction services and automotive marketing data and technology.

We expect our results of operations and financial condition during 2005 to be adversely affected by higher than expected operating costs, including an increase in customer acquisition costs and costs relating to compliance with the Sarbanes-Oxley Act of 2002, as well as costs associated with the restatements of our consolidated financial statements which were filed on May 31, 2005, the internal review relating to the restatements, and the remediation of material weaknesses in our internal controls identified in our internal review. In addition, costs associated with defending purported class action, derivative and other lawsuits filed against us and certain current and former directors and officers relating to the restatements of our consolidated financial statements, and costs associated with enforcing our intellectual property rights, including the lawsuit filed against Dealix Corporation for patent infringement, are also expected to increase our operating costs and adversely affect our results of operations and financial condition.

On April 19, 2005, we took steps to commit to integrate the business operations of our customer loyalty and retention marketing program, Retention Performance Marketing, with our customer lead management product, Web Control ® (the "Integration"). During the third quarter of 2005, we determined not to proceed with the Integration. However, we are in the process of closing our Houston office and moving the operations of such office to our office in Irvine, California. Certain employees in the Houston office may relocate to our office in Irvine, California. We expect to complete the move by December 31, 2005.

As we previously announced on October 24, 2005, we retained the services of Merrill Lynch & Co. to assist us in exploring strategic alternatives, which may include potential acquisitions of, or mergers with, complementary businesses, as well as a potential sale of the company.

We expect revenue from our business for the remainder of 2005 to be lower than the remainder of 2004. We also expect the percentage of 2005 revenues from lead fees to decrease and the percentage of revenues from CRM services and advertising to increase, in each case, from 2004.

As of September 30, 2005, we had $44.1 million in domestic cash, cash equivalents, and short-term and long-term investments.

Net cash used in operations was $0.2 million in the third quarter of 2005. We may continue to use cash from operations for the remainder of 2005.

Our lead referral dealer relationships represent every major domestic and imported make of vehicle and light truck sold in the United States. As of September 30, 2005, our lead referral dealer relationships, excluding dealer enterprise relationships attributable to automotive manufacturers or their automotive buying service affiliates, totaled approximately 6,560, encompassing approximately 5,850 retail dealer relationships (including approximately 250 suspended dealers) and relationships with major dealer groups representing approximately 710 enterprise dealer relationships. Additionally, our lead referral dealer relationships include six direct relationships encompassing 16 brands with automotive manufacturers or their automotive buying service affiliates through our enterprise sales initiatives representing up to approximately 17,530 enterprise dealer relationships. As of September 30, 2005, approximately 810 retail dealers had more than one retail lead referral dealer relationship with us. A majority of our revenue from lead referral dealer relationships is derived from retail dealer relationships and enterprise dealer relationships with major dealer groups. In addition, as of September 30, 2005, our finance lead referral network included approximately 310 relationships with retail dealers, finance request intermediaries, and automotive finance companies who participate in our Car.com finance referral network. As of September 30, 2005, CRM customer relationships consisted of 2,940 Web Control, our lead management product, and 780 Retention Performance Marketing ® (RPM ®), our customer loyalty and retention marketing program, relationships. As an example of how we calculate these relationships, a dealer that subscribes to the Autobytel.com new car program and the Autoweb.com new car program accounts for two retail dealer relationships, and a dealer that subscribes to our Web Control product and RPM program accounts for two CRM customer relationships. As a further example, a dealer group that owns three different franchises and that subscribes to the Autoweb.com new car program for all such franchises accounts for three retail dealer relationships. Web Control customer relationships are accounted for based on the number of customers using Web Control, rather than the number of franchises owned by a given customer. We no longer include iManager SM (our legacy lead management tool) product relationships within CRM customer relationships, as we are offering dealers who use iManager the opportunity to migrate to Web Control. Suspended dealer relationships are relationships with dealers to whom the delivery of purchase requests or performance of services has been suspended. The suspension may be initiated by us or the dealers for various reasons, including but not limited to nonpayment by dealers or dealers temporarily not having an Internet manager. The number of dealer relationships and customer relationships as of September 30, 2005 referred to above was determined in conformity with the methodology described above.

We conduct our business within one business segment, which is defined as providing automotive marketing services.

Lead fees consist of car buying purchase request fees for new and used cars, and finance request fees.

Fees for car buying purchase requests are paid by retail dealers, enterprise dealers and automotive manufacturers or their buying service affiliates who participate in our online car buying referral networks. Beginning April 15, 2004, lead fees include fees paid by retail dealers, enterprise dealers and automotive manufacturers who participate in our Car.com online car buying referral network. Enterprise dealers consist of (i) dealers that are part of major dealer groups with more than 25 dealerships with whom we have a single agreement and (ii) dealers that are eligible to receive purchase requests from us as part of a single agreement with an automotive manufacturer or its automotive buying service affiliate. Major dealer groups include AutoNation and automotive manufacturers include manufacturers such as General Motors, Ford and Mazda. Fees paid by customers participating in our car buying referral networks are comprised of monthly subscription and transaction fees for consumer leads, or purchase requests, which are directed to participating dealers. These monthly subscription and transaction fees are recognized in the period service is provided. Ongoing fixed monthly subscription fees are based, among other things, on the size of territory, demographics and, indirectly, the transmittal of purchase requests to customers participating in our car buying referral networks. Transaction fees are based on the number of purchase requests provided to retail and enterprise dealers and automotive manufacturers each month.

Generally, our dealer contracts are terminable on 30 days’ notice by either party. As of September 30, 2005, a major manufacturer in our program accounted for up to approximately 8,100 enterprise dealer relationships. This program with such major manufacturer automatically extends in one-month increments until terminated by us or the manufacturer. From time to time, a major dealer group or automotive manufacturer may significantly increase or decrease the number of enterprise dealers participating in our dealer networks or the number of purchase requests accepted from us.

Beginning April 15, 2004, lead fees also include fees paid by retail dealers, finance request intermediaries, and automotive finance companies who participate in our Car.com finance referral network. Customers participating in our Car.com finance referral network pay ongoing monthly subscription fees or transaction fees based on the number of finance requests provided to them each month. The fees are recognized in the period service is provided.

For the three months ended September 30, 2005 and 2004, lead fees were $18.6 million and $22.4 million, or 61% and 69% of total revenues in the third quarter of 2005 and 2004, respectively. We expect to derive a majority of our revenues in the foreseeable future from retail dealers, enterprise dealers and automotive manufacturers that participate in our online car buying referral networks and dealers, finance request intermediaries, and automotive finance companies that participate in our Car.com finance referral network. We anticipate that our lead fee revenue in 2005 will decrease compared to 2004 due to lower revenues from retail dealers, partially offset by higher finance request revenue.

Advertising revenues represent fees from automotive manufacturers and other advertisers who target car buyers during the research, consideration and decision making process on our Web sites, as well as through direct marketing offerings. Using the targeted nature of Internet advertising, manufacturers can advertise their brands effectively on any of our Web sites by targeting advertisements to consumers who are researching vehicles, thereby increasing the likelihood of influencing their purchase decisions.

Revenues from advertising were $4.8 million and $3.6 million, or 16% and 11% of total revenues, in the third quarter of 2005 and 2004, respectively. With further selling of additional advertising inventory, an increase in Internet advertising spending by automotive manufacturers, the acquisition of Stoneage in April 2004 and the addition of new and higher priced products, such as rich media and direct marketing offerings, we anticipate that our advertising revenues in 2005 will increase compared to 2004.

CRM services consist of fees paid by customers who use our customer retention and lead management products. Customer retention and lead management products consist of the Web Control system (Web Control), our customer lead management product, Retention Performance Marketing (RPM) and iDriveonline, our customer loyalty and retention marketing programs, and Automotive Download Services (ADS), our data extraction service. CRM services include fees from Web Control and ADS and fees from dealers using the iDriveonline program beginning April 9, 2004. Customers using our CRM services pay transaction fees based on the specified service, or ongoing monthly subscription fees based on the level of functionality selected from our suite of lead management products. Revenues from CRM services were $6.2 million and $5.4 million, or 20% and 17% of total revenues, in the third quarter of 2005 and 2004, respectively. We expect revenues from our CRM services to increase in 2005 compared to 2004 primarily due to the acquisition of iDriveonline in April 2004 and growth in AVV.

Revenues from data, applications and other include fees from automotive marketing data and technology, classified listings for used cars, international licensing agreements, internet sales training and other products and services. Revenues from data, applications and other were $1.1 million, or 3% of total revenues, in both the third quarter of 2005 and 2004. We develop data for use on our Web sites, and also make it available to third parties, such as automotive manufacturers and internet portals. We continue to focus our efforts on offering marketing services to dealers and automotive manufacturers. We expect revenues from data, applications and other to decline in 2005 compared to 2004.

To enhance the quality of purchase requests, each purchase request is passed through our Quality Verification System (QVS) SM which uses filters and validation processes to identify consumers with valid purchase intent before delivering the purchase request to our retail and enterprise dealers. We believe the implementation of these quality enhancing processes allows us to deliver high quality purchase requests to our retail and enterprise dealers. High quality purchase requests are those that result in high closing ratios. Closing ratio is the ratio of the number of vehicles purchased at a dealer generated from purchase requests to the total number of purchase requests sent to that dealer.

We delivered approximately 0.8 million and 1.1 million purchase requests through our online systems to retail and enterprise dealers in the third quarter of 2005 and 2004, respectively. Of these, approximately 0.5 million and 0.7 million were delivered to retail dealers in the third quarter of 2005 and 2004, respectively, and approximately 0.3 million and 0.4 million were delivered to enterprise dealers in the third quarter of 2005 and 2004, respectively. The number of purchase requests we delivered to our retail and enterprise dealers in the third quarter of 2005 declined by 0.1 million compared to the second quarter of 2005. Management is taking actions to reverse this trend. However, we cannot assure that this trend will not continue.

Additionally, we delivered approximately 0.2 million finance requests in both the third quarter of 2005 and 2004 to retail dealers, finance request intermediaries, and automotive finance companies. We expect that the number of finance requests we deliver to retail dealers, finance request intermediaries, and automotive finance companies will increase in 2005 compared to 2004.

To enhance our retail dealers' ability to sell cars using our programs, we developed and implemented various products and processes that allow us to provide high quality dealer support. We contact all retail dealers new to our programs to confirm their initiation on our programs and train their designated personnel on the use of our programs and products. We also contact our retail dealers on a regular basis to identify retail dealers who are not using our programs effectively, develop relationships with retail dealer principals and their personnel responsible for calling consumers and to inform our retail dealers about their effectiveness using surveys completed by purchase-intending consumers.

Our relationship with retail dealers may terminate for various reasons including:

- termination by the dealer due to issues with purchase request volume, purchase request quality, fee increases or lack of dedicated personnel to manage the program effectively,

- termination by us due to the dealer providing poor customer service to consumers or for nonpayment of fees by the dealer,
- termination by us of dealers that cannot provide us with a reasonable profit,
- extinction of the manufacturer brand, or
- sale or termination of the dealer franchise.

From time to time as we sign major dealer groups to receive purchase requests, dealers that are part of such groups and previously represented retail dealer relationships are counted as enterprise dealer relationships. During the third quarter of 2005, approximately 50 retail dealer relationships were transferred to enterprise dealer relationships in connection with signing major dealer groups. In the third quarter of 2005, we experienced a net reduction of approximately 180 in our number of retail dealer relationships. We believe that the employee pricing by automotive manufacturers which took place during the third quarter of 2005 contributed to the decline in retail dealer relationships. We cannot assure that we will be able to reduce the net decline in our number of retail dealer relationships. Our inability or failure to reduce such decline, which may be impacted by items such as employee discount pricing programs offered by manufacturers, could have a material adverse effect on our business, results of operations and financial condition.

Because our primary revenue source is from lead fees, our business model is different from many other Internet commerce sites. The automobiles requested through our Web sites are sold by dealers; therefore, we derive no direct revenues from the sale of a vehicle and have no procurement, carrying or shipping costs and no inventory risk.

Results of Operations

The following table sets forth our results of operations as a percentage of revenues:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues	100%	100%	100%	100%
Costs and expenses:				
Cost of revenues	42	40	41	41
Sales and marketing	20	19	22	22
Product and technology development	19	16	19	17
General and administrative	21	14	25	14
Amortization of acquired intangible assets	1	—	1	1
Total costs and expenses	103	89	108	95
Income (loss) from operations	(3)	11	(8)	5
Other income	1	—	1	1
Income (loss) before income taxes	(2)	11	(7)	6
Benefit (provision) for income taxes	1	—	—	—
Net income (loss)	(1)%	11%	(7)%	6%

Revenues by groups of similar services are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Lead fees	$18,560	$22,414	$59,884	$61,378
Advertising	4,832	3,551	14,090	9,818
CRM services	6,151	5,382	17,949	13,342
Data, applications and other	1,052	1,106	3,385	3,655
Total revenues	$30,595	$32,453	$95,308	$88,193

Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004

Revenues. Our revenues decreased by $1.9 million, or 6%, to $30.6 million in the third quarter of 2005 compared to $32.5 million in the third quarter of 2004. The decrease was due to decrease in lead fees, offset by growth in CRM services and advertising.

Lead Fees. Lead fees decreased by $3.9 million, or 17%, to $18.6 million in the third quarter of 2005 compared to $22.4 million in the third quarter of 2004. The decrease was driven by a decline of 0.3 million in purchase requests delivered. The number of retail dealer relationships in our lead referral program was approximately 5,850 and 6,400 at September 30, 2005 and 2004, respectively. The number of enterprise dealer relationships with major dealer groups in our lead referral program was approximately 710 and 690 at September 30, 2005 and 2004, respectively. In addition, we had six direct relationships encompassing 16 brands with automotive manufacturers or their automotive buying service affiliates representing up to approximately 17,530 enterprise dealer relationships at September 30, 2005, compared to six direct relationships encompassing 16 brands representing up to approximately 17,200 enterprise dealer relationships at September 30, 2004. Our finance lead referral network at September 30, 2005 and 2004 also included approximately 310 and 260, respectively, relationships with retail dealers, finance request intermediaries, and automotive finance companies who participate in the Car.com finance referral network. Lead fees and the number of purchase requests we delivered to our customers continued to decline in the third quarter of 2005 compared to the first and second quarters of 2005. Management is taking actions to reverse this trend. However, we cannot assure that this trend will not continue.

Advertising. Advertising revenue increased by $1.3 million, or 36%, to $4.8 million in the third quarter of 2005 compared to $3.6 million in the third quarter of 2004. The increase was primarily due to higher spending by automotive manufacturers and the addition of new products, such as rich media and direct marketing offerings. With further selling of additional available advertising inventory, an increase in Internet advertising spending by automotive manufacturers and the addition of new and higher priced products, such as rich media and direct marketing offerings, we expect our advertising revenues to increase in 2005 compared to 2004.

CRM Services. CRM services increased by $0.8 million, or 14%, to $6.2 million in the third quarter of 2005 compared to $5.4 million in the third quarter of 2004. The increase was due to an increase in the number of Web Control and RPM customers. The number of Web Control customers and RPM customers were 2,940 and 780, respectively, at September 30, 2005 compared to approximately 2,720 and 730, respectively, at September 30, 2004. We expect revenues from our CRM services to increase in 2005 compared to 2004 due to the acquisition of iDriveonline in April 2004 and growth in AVV.

Data, Applications and Other. Revenues from data, applications and other in the third quarter of 2005 was flat when compared to the third quarter of 2004. We expect data, applications and other to decline in 2005 compared to 2004.

Cost of Revenues . Cost of revenues consists of traffic acquisition costs (“TAC”) and other cost of revenues. TAC consists of payments made to our internet purchase providers, including internet portals and online automotive information providers. Other cost of revenues consists of printing, production, and postage for our customer loyalty and retention programs, fees paid to third parties for data and content included on our properties, connectivity costs, technology license fees, server equipment depreciation and technology amortization and compensation related expense.

Cost of revenues decreased by $0.2 million or 2% to $12.8 million in the third quarter of 2005 compared to $13.0 million in the third quarter of 2004. This represents 42% and 40% of total revenues in the third quarter of 2005 and 2004, respectively. The decrease was due to a $0.5 million decrease in the costs of purchase requests acquired from third parties and a $0.1 million decrease in amortization of capitalized internal use software, offset by a $0.3 million increase in printing, production, and postage costs for our customer loyalty and retention program and a $0.1 million increase in personnel and related costs. The decrease in purchase request costs was primarily due to the decreased delivery of purchase requests. The decrease in amortization of capitalized internal use software was due to certain costs that were fully amortized in 2004. The increase in printing, production and postage costs was due to the increase in customer loyalty and retention program volumes in our RPM business. We expect our costs of revenue in 2005 to be comparable to 2004.

Sales and Marketing. Sales and marketing expense includes costs for developing our brand equity and personnel and other costs associated with dealer sales, CRM sales, Web site advertising sales, and dealer training and support. Sales and marketing expense decreased by $0.3 million or 4% to $6.1 million in the third quarter of 2005 compared to $6.3 million in the third quarter of 2004. This represents 20% and 19% of total revenues in the third quarter of 2005 and 2004, respectively. The decrease was due to a $0.6 million decrease in traditional advertising, offset by a $0.1 million increase in costs associated with sales and customer relationship maintenance and a $0.2 million increase in other marketing costs. We expect our sales and marketing expenses to increase in 2005 compared to 2004.

Product and Technology Development. Product and technology development expense includes personnel costs related to developing new products, enhancing the features, content and functionality of our Web sites and our Internet-based communications platform, costs associated with our telecommunications and computer infrastructure, and costs related to data and technology development. Product and technology development expense increased by $0.6 million, or 12%, to $5.7 million in the third quarter of 2005 compared to $5.1 million in the third quarter of 2004. This represents 19% and 16% of total revenues for the third quarter of 2005 and 2004, respectively. The increase was due to higher personnel and related costs of $0.6 million, a $0.1 million in retention and severance costs associated with the relocation of the Houston office and a $0.1 million increase in telephone costs related to our voice communications, offset by a $0.2 decrease in other costs. The higher personnel and related costs are associated with the increase in headcount. We expect our product and technology development expenses to increase in 2005 compared to 2004.

General and Administrative. General and administrative expense consists of executive, financial and legal personnel expenses and costs related to being a public company. General and administrative expense increased by $2.1 million, or 47%, to $6.5 million in the third quarter of 2005 compared to $4.4 million in the third quarter of 2004. This represents 21% and 14% of total revenues for the third quarter of 2005 and 2004, respectively. The increase was primarily due to an increase in legal fees of $1.0 million, of which $0.6 million was associated with enforcing our intellectual property rights, $0.3 million was associated with defending purported class action and derivative lawsuits filed against us and $0.1 million was related to other legal matters, a $0.6 million increase in temporary personnel costs, a $0.5 million increase in the estimated bonus accrual in the third quarter of 2005 and a $0.1 million increase in insurance costs. These increases were offset by a $0.1 million decrease in the estimated provision for bad debt. We expect our general and administrative expenses to increase in 2005 compared to 2004 due to costs relating to compliance with the Sarbanes-Oxley Act of 2002, costs associated with our internal review and the remediation of material weaknesses in our internal control over financial reporting identified in our internal review, costs associated with defending purported class action, derivative and other lawsuits filed against us and certain current and former directors and officers relating to the restatements of our consolidated financial statements, and costs associated with enforcing our intellectual property rights, including the lawsuit filed against Dealix Corporation for patent infringement.

Amortization of Acquired Intangible Assets. Amortization of acquired intangible assets represents the amortization of customer relationships and domain name recorded as part of the AVV, iDriveonline and Stoneage acquisitions. Amortization of acquired intangible assets decreased by $0.1 million to $0.4 million in the third quarter of 2005 compared to $0.5 million in the third quarter of 2004. The decrease was due to decline in business with certain key customers of iDriveonline and Stoneage resulting in impairment losses recorded during the last half of 2004 and the second quarter of 2005.

Interest Income. In the third quarter of 2005, interest income increased by $0.2 million, to $0.4 million compared to $0.2 million in the third quarter of 2004. The increase in interest income was due to the investment of our cash in accounts yielding higher interest rates.

Minority Interest. Minority interest represents the portion of Autobytel.Europe's net income allocable to Autobytel.Europe's other shareholder.

Income Taxes. State income tax benefit was $0.1 million in the third quarter of 2005 compared to the provision for state income taxes of $0.1 million in the third quarter of 2004. The decrease is primarily due to state income tax refunds related to the calendar year 2004 state income tax returns filed in the third quarter of 2005. In the preparation of our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate, including estimating both our actual current tax exposure and assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. We have net operating loss carryforwards that expire in various years through 2024. We also have federal and state research tax credit carryforwards. The federal research tax credits expire in various years through 2022. The state research tax credits do not expire. Utilization of these carryforwards is subject to an annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. The annual limitation may result in the expiration of the carryforwards before utilization. To the extent that we have deferred tax assets, we must assess the likelihood that our deferred tax assets will be recovered from taxable temporary differences, tax strategies or future taxable income and to the extent that we believe that recovery is not likely, we must establish a valuation allowance. At the end of each reporting period, we evaluate whether it is more likely than not that our deferred tax assets are not realizable. While we believe that such deferred tax assets were not realizable at September 30, 2005, our assessment may change in future periods if we generate positive operating results and such adjustment would impact our provision for income taxes in the period of such change.

Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004

Revenues. Our revenues increased by $7.1 million, or 8%, to $95.3 million for the nine months ended September 30, 2005 compared to $88.2 million for the same period in 2004. The increase was due to growth in CRM services and advertising. CRM services growth benefited by us having owned the operation of iDriveonline for a full nine months.

Lead Fees. Lead fees decreased by $1.5 million, or 2%, to $59.9 million for the nine months ended September 30, 2005 compared to $61.4 million for the same period in 2004. The decrease was due to a decline of 0.3 million purchase requests delivered to our retail dealers, offset by an additional 0.3 million finance requests delivered to dealers, finance request intermediaries, and automotive finance companies for the nine months ended September 30, 2005 when compared to the same period in 2004. The increase in finance requests was due to the benefit of having owned the operation of Car.com for a full nine months in 2005.

Advertising. Advertising revenue increased by $4.3 million, or 44%, to $14.1 million for the nine months ended September 30, 2005 compared to $9.8 million for the same period in 2004. The increase was primarily due to higher spending by automotive manufacturers, the addition of new products, such as rich media and direct marketing offerings in the second half of 2004 and the benefit of having owned the operation of Car.com for a full nine months in 2005.

CRM Services. CRM services increased by $4.6 million, or 35%, to $17.9 million for the nine months ended September 30, 2005 compared to $13.3 million for the same period in 2004. The increase was due to an increase in RPM revenues, primarily due to the benefit of having owned the operation of iDriveonline for a full nine months in 2005 coupled with its higher fees from its customer loyalty and retention marketing programs. Also, the increase was due to an increase in the number of Web Control and RPM customers. The number of Web Control customers and RPM customers were 2,940 and 780, respectively, at September 30, 2005 compared to approximately 2,720 and 730, respectively, at September 30, 2004.

Data, Applications and Other. Revenues from data, applications and other decreased by $0.3 million, or 7%, to $3.4 million for the nine months ended September 30, 2005 compared to $3.7 million for the same period in 2004. The decrease was primarily due to a decrease in fees from classified advertising that was discontinued in the second quarter of 2005 and a program offered to credit unions that was discontinued in the fourth quarter of 2004.

Cost of Revenues. Cost of revenues consists of TAC and other cost of revenues. TAC consists of payments made to our internet purchase providers, including internet portals and online automotive information providers. Other cost of revenues consists of printing, production, and postage for our customer loyalty and retention programs, fees paid to third parties for data and content included on our properties, connectivity costs, technology license fees, server equipment depreciation and technology amortization and compensation related expense.

Cost of revenues increased by $2.4 million or 7% to $38.9 million for the nine months ended September 30, 2005 compared to $36.5 million for the same period in 2004. This represents 41% of total revenues for both the nine months ended September 30, 2005 and 2004. The increase was due to a $1.6 million increase in printing, production, and postage costs, a $1.5 million increase in the costs of purchase and finance requests acquired from third parties and a $0.2 million increase in amortization of acquired technology. This increase was offset by a $0.5 million decrease in the amortization of capitalized internal use software, a $0.2 million decrease in depreciation expense, a $0.1 million decrease in compensation costs and a $0.1 million decrease in other costs. The increase in printing, production and postage costs was primarily due to the increase in customer loyalty and retention program volumes in our RPM business. The increase in purchase request and finance request costs was primarily due to the increased delivery of finance requests. The increase in amortization of acquired technology was a result of the acquisitions of Stoneage and iDriveonline. The decrease in depreciation and amortization of capitalized internal use software was due to certain costs that were fully depreciated and amortized in 2004.

Sales and Marketing. Sales and marketing expense increased by $1.7 million, or 9%, to $21.2 million for the nine months ended September 30, 2005 compared to $19.4 million for the same period in 2004. This represents 22% of total revenues for both the nine months ended September 30, 2005 and 2004. The increase was due to a $2.1 million increase in costs associated with sales and customer relationship maintenance, a $0.2 million increase in marketing personnel and related costs and a $0.1 million increase in other costs, offset by a $0.7 million decrease in traditional advertising expenses. The increase in sales and customer relationship maintenance and marketing personnel and related costs was due to higher personnel costs related to increased headcount and severance costs associated with the separation of two employees from us.

Product and Technology Development. Product and technology development expense increased by $3.1 million, or 21%, to $18.1 million for the nine months ended September 30, 2005 compared to $14.9 million for the same period in 2004. This represents 19% and 17% of total revenues for the nine months ended September 30, 2005 and 2004, respectively. The increase was due to higher personnel and related costs of $2.5 million, a $0.1 million in severance costs associated with the separation of three employees from us, a $0.1 million in retention and severance costs associated with the relocation of the

Houston office, a $0.2 million increase in telephone costs related to our voice communications and a $0.2 million in other costs. The higher personnel and related costs is associated with the increase in headcount, largely from the acquisition of iDriveonline and Stoneage.

General and Administrative. General and administrative expense increased by $11.4 million, or 95%, to $23.3 million for the nine months ended September 30, 2005 compared to $11.9 million for the same period in 2004. This represents 25% and 14% of total revenues for the nine months ended September 30, 2005 and 2004, respectively. The increase was primarily due to costs associated with the internal review, restatements and audits of our consolidated financial statements of $6.0 million, an increase in legal fees of $2.6 million, of which $1.4 million was associated with enforcing our intellectual property rights, $0.5 million was associated with defending purported class action and derivative lawsuits filed against us and $0.7 million was related to other legal matters, a $1.1 million increase in temporary personnel costs, a $0.6 million increase in compensation costs due to increase headcount, a $0.2 million increase in consulting fees related to the documentation and testing of the effectiveness of our internal control over financial reporting, a $0.3 million increase in recruiting costs, a $0.1 million increase in the estimate of bad debt expense, a $0.4 million reduction in the estimated provision for bad debt in 2004, a $0.3 million increase in insurance costs and a $0.2 million increase in other costs. These increases were offset by a $0.3 million charge related to an abandoned acquisition in 2004 and a $0.1 million severance charge associated with the separation of an employee in 2004.

Amortization of Acquired Intangible Assets. Amortization of acquired intangible assets represents the amortization of customer relationships and domain name recorded as part of the AVV, iDriveonline and Stoneage acquisitions. Amortization of acquired intangible assets increased by $0.4 million for the nine months ended September 30, 2005 compared to the same period in 2004. The increase was primarily due to the acquisitions of iDriveonline and Stoneage.

Interest Income. In the nine months ended September 30, 2005, interest income increased by $0.5 million, to $1.1 million compared to $0.6 million for the same period in 2004. The increase in interest income was due to the investment of our cash in accounts yielding higher interest rates.

Loss in Equity Investee. Loss in equity investee in the nine months ended September 30, 2004 represents our share of loss in Autobytel.Europe prior to the adoption of FIN 46R.

Minority Interest. Minority interest represents the portion of Autobytel.Europe’s net income allocable to Autobytel.Europe’s other shareholder.

Provision for Income Taxes. Provision for income taxes decreased $0.2 million to $0.1 million for the nine months ended September 30, 2005 compared to $0.3 million for the same period in 2004. The decrease is primarily due to state income tax refunds related to the calendar year 2004 state income tax returns filed in the third quarter of 2005.

Stock Options Granted in 2005

From January 1, 2005 through September 30, 2005, we granted stock options to purchase 1,642,500 shares of common stock under our 1996 Stock Incentive Plan, 1998 Stock Option Plan, 1999 Stock Option Plan, 1999 Employee and Acquisition Related Stock Option Plan, 2000 Stock Option Plan, Amended and Restated 2001 Restricted Stock and Option Plan and 2004 Restricted Stock and Option Plan. The stock options were granted at our common stock closing price on the date of grant. As of September 30, 2005, we had approximately 8.8 million outstanding stock options.

Employees

As of October 31, 2005, we had a total of 421 employees. We also utilize independent contractors as required. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our employee relations to be good.

Liquidity and Capital Resources

Our domestic cash, cash equivalents, and short-term and long-term investments totaled $44.1 million as of September 30, 2005, representing a decrease of $1.0 million in the third quarter of 2005. As of September 30, 2005, we had $29.1 million in domestic cash and cash equivalents. As of September 30, 2005, restricted international cash and cash equivalents held by Autobytel.Europe were $8.5 million for use as directed by Autobytel.Europe. Restricted international cash and cash equivalents are not available to us. Although there is no assurance, we expect to receive our share, or 49%, of the net assets of Autobytel.Europe prior to the end of the first half of 2006.

Net cash used in operating activities was $6.6 million for the nine months ended September 30, 2005 compared to net cash provided by operating activities of $3.3 million for the same period in 2004. Net cash used in operating activities for the nine months ended September 30, 2005 resulted from a net loss of $6.4 million for the period, a $4.5 million increase in accounts receivable, $1.0 million increase in prepaid expenses and other current assets and a $0.9 million decrease in accounts payable and accrued expenses, which were partially offset by non-cash charges. The increase in accounts receivable was primarily due to the increase in days sales outstanding from 53 days during the nine months ended December 31, 2004 to 59 days for the nine months ended September 30, 2005. The increase in prepaid expenses and other current assets was primarily due to the payment of insurance premiums during the first half of 2005, partially offset by the amortization of the insurance premiums. The decrease in accounts payable and accrued expenses was primarily due to payout of accrued compensation costs in the first half of 2005, partially offset by the accrual of compensation costs for the nine months ended September 30, 2005.

Net cash provided by operating activities for the nine months ended September 30, 2004 resulted from net income for the period before non-cash charges, partially offset by an increase in accounts receivable, prepaid expenses and other current assets coupled with a decrease in accounts payable, accrued expenses, deferred revenues and accrued international licensee liabilities. A $2.2 million increase in accounts receivable was due to higher billing as a result of increased revenues. A $0.5 million increase in prepaid expenses and other current assets was primarily due to the payment of insurance premiums during the first half of 2004, prepaid postage and other prepaid expenses, offset by the amortization of the insurance premiums. A $0.4 million decrease in accounts payable was primarily due to the payout of the liabilities assumed from the acquisition of Stoneage and iDriveonline. A $1.0 million decrease in accrued expenses was primarily due to the payout of accrued compensation costs. A $0.6 million decrease in deferred revenue is primarily due to revenue recognized for our services provided to iDriveonline dealers that were billed prior to the acquisition of iDriveonline, and a decline in deferred revenue related to Web site advertising, automotive data and technology license fees, international license fees and dealers paying ongoing fixed monthly subscription fees for the nine months ended September 30, 2004 that were billed in 2003. A $1.5 million decrease in accrued international licensee liabilities was due to payments made in April 2004 by Autobytel.Europe to Autobytel.Europe licensees for amounts due under agreements entered into in March 2002.

Net cash provided by investing activities was $11.1 million for the nine months ended September 30, 2005 compared to net cash used in investing activities of $32.6 million for the same period in 2004. Cash provided by investing activities for the nine months ended September 30, 2005 was related to the sale and maturities of short-term investment in government sponsored agency bonds and auction rate securities, offset by purchases of short-term and long-term investments in government sponsored agency bonds and auction rate securities and purchases of property and equipment. Cash used in investing activities in the nine months ended September 30, 2004 was related to the acquisitions of Stoneage and iDriveonline, net purchases of short-term and long-term investments in government sponsored agency bonds and auction rate securities and purchases of property and equipment, offset by the increase in restricted cash.

Net cash provided by financing activities was $0.3 million for the nine months ended September 30, 2005 compared to $3.8 million for the same period in 2004. Cash provided by financing activities in the nine months ended September 30, 2005 was due to proceeds received from the sale of common stock through our employee stock purchase plan and the exercise of stock options. Cash provided by financing activities in the nine months ended September 30, 2004 was due to proceeds received from the sale of common stock through our employee stock purchase plan and the exercise of stock options, offset by payments of capital lease obligations assumed in the Stoneage acquisition.

Our cash requirements depend on several factors, including:

- the level of expenditures on marketing and advertising, including the cost of contractual arrangements with Internet portals, online information providers and other referral sources,
- the level of expenditures on product and technology development,

- the level of expenditures for general and administrative matters, including compliance with the Sarbanes-Oxley Act of 2002,
- the ability to increase the volume of purchase requests and finance requests and transactions related to our Web sites,
- the amount and timing of cash collection and disbursements,
- the cash portion of acquisition transactions and joint ventures, and
- costs of ongoing litigation and any adverse judgments resulting from such litigation.

We estimate and record allowances for potential bad debts and customer credits based on our historical bad debt and customer credit experience, which is consistent with our past practice.

The allowance for bad debts is our estimate of bad debt expense that could result from the inability or refusal of our customers to pay for our services. Additions to the estimated reserve for bad debts are recorded as an increase in general and administrative expenses. Reductions in the estimated reserve for bad debts are recorded as a decrease in general and administrative expenses. As specific bad debts are identified, they are written-off against the previously established estimated reserve for bad debts and have no impact on operating expenses.

The allowance for customer credits is our estimate of adjustments for services that do not meet our customers' perceived expectations. Additions to the estimated reserve for customer credits are recorded as a reduction in revenues. Reductions in the estimated reserve for customer credits are recorded as an increase in revenues. As specific customer credits are identified, they are written-off against the previously established estimated reserve for customer credits and have no impact on revenues.

During the three months and nine months ended September 30, 2005, we added $1.1 million and $3.0 million, respectively, to our domestic allowances for bad debts and customer credits. Also during the three months and nine months ended September 30, 2005, we wrote-off $1.0 million and $2.8 million, respectively, from our previously established allowances for bad debts and customer credits. The write-offs had no impact on our revenues or operating expenses. As of September 30, 2005, our estimated allowances for domestic bad debts and customer credits have increased to $1.2 million, or 6% of gross accounts receivable from $1.0 million, or 5%, of gross accounts receivable as of December 31, 2004.

If there is a decline in the general economic environment that negatively affects the financial condition of our customers or an increase in the number of customers that are dissatisfied with our services, additional estimated allowances for bad debts and customer credits may be required and the impact on our business, results of operations or financial condition could be material.

We do not have debt. We believe our current cash and cash equivalents are sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months.

While we forecast and budget cash requirements, assumptions underlying the estimates may change and could have a material impact on our cash requirements. If our uses of funds vary materially from those currently planned, we may require additional financing sooner than anticipated. We have no commitments for any additional financing, and there can be no assurance that any such commitments can be obtained on favorable terms, if at all.

In 2005, we renewed our leases for our facilities in Irvine, California and Houston, Texas, which expire in September 2010 and December 2005, respectively. Additionally, we entered into a new lease for our facilities in Troy, Michigan, which expires in December 2010. Our contractual commitments associated with these lease obligations totaled $6.8 million as of September 30, 2005.

Recent Accounting Pronouncements

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 123R (revised 2004), "Share-Based Payment", which revised SFAS No. 123, "Accounting for Stock-Based Compensation". This statement supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". The revised statement addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the ability to account for share-based compensation transactions using APB 25 and requires that the compensation costs relating to such transactions be recognized in the consolidated statement of operations. The revised statement is effective as of the first annual period beginning after June 15, 2005. In accordance with the revised statement, we will be required to recognize the expense attributable to stock options granted or vested subsequent to December 31, 2005. We expect the adoption of SFAS 123R will result in amounts that are similar to the current pro forma disclosures in Note 2 of the Notes to Consolidated Financial Statements.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets, an amendment of APB Opinion No. 29," ("SFAS 153"). SFAS 153 addresses the measurement of exchanges of non-monetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS 153 is effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS 153 is not expected to have a material effect on our consolidated financial position or results of operations.

On March 29, 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") 107 which expresses the views of the SEC regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provides the SEC's views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB 107 provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management's Discussion and Analysis of Financial Condition and Results of Operations subsequent to adoption of SFAS No. 123R. We do not expect the impact of SAB 107, which became effective on March 29, 2005, to have a material impact on our consolidated financial position, results of operations or cash flows.

In May 2005, Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 154, "Accounting Changes and Error Corrections " ("SFAS 154"). SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle. It also requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. The statement will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not expect the adoption of SFAS 154 to have a material effect on our consolidated financial position or results of operations.

Risk Factors

In addition to the factors discussed in the "Overview" and "Liquidity and Capital Resources" sections of "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report on Form 10-Q, the following additional factors may affect our future results.

We have only been profitable from the fourth quarter of 2002 through the fourth quarter of 2004 and otherwise have a history of net losses. We incurred a loss in the first, second and third quarters of 2005 and cannot assure that we will be profitable in the future. If we are unable to achieve profitability in the future and we lose money, our operations will not be financially viable.

Because of the relatively recent emergence of the Internet-based vehicle information and purchasing industry, none of our senior executives has long-term experience in the industry. This limited operating history contributes to our difficulty in predicting future operating results.

We have incurred losses every quarter through the third quarter of 2002 and have achieved profitability from the fourth quarter of 2002 through the fourth quarter of 2004. We incurred a loss for the nine months ended September 30, 2005, primarily because of the costs related to the restatements of our financial statements and the internal review related to those restatements. We cannot assure that we will be profitable in the future. We had an accumulated deficit of $154.7 million as of September 30, 2005 and $148.4 million as of December 31, 2004.

Our potential for future profitability must be considered in light of the risks, uncertainties, expenses and difficulties frequently encountered by companies in emerging and rapidly evolving markets, such as the market for Internet commerce. We believe that to achieve and sustain profitability, we must, among other things:

- generate increased vehicle buyer traffic to our Web sites,
- successfully introduce new products and services,
- continue to send new and used vehicle purchase requests to dealers that result in sufficient dealer transactions to justify our fees,
- expand the number of dealers in our networks and enhance the quality of dealers,
- sustain and expand our relationships with automotive manufacturers,
- identify and successfully consummate and integrate acquisitions,
- respond to competitive developments,
- maintain a high degree of customer satisfaction,
- provide secure and easy to use Web sites for customers,
- increase visibility of our brand names,
- defend and enforce our intellectual property rights,
- design and implement effective internal controls systems,
- continue to attract, retain and motivate qualified personnel, and
- continue to upgrade and enhance our technologies to accommodate expanded service offerings and increased consumer traffic.

We cannot be certain that we will be successful in achieving these goals or that if we are successful in achieving these goals, that we will be profitable in the future.

Our internal controls and procedures need to be improved.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. In making its assessment of internal control over financial reporting as of December 31, 2004, management used the criteria described in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. A material weakness is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Management determined that we had material weaknesses in our internal control over financial reporting as of December 31, 2004, and these material weaknesses led to the restatement of our consolidated financial statements for the full 2002 fiscal year, the first, second, and third fiscal quarters of 2003, the full 2003 fiscal year and the first and second fiscal quarters of 2004. The material weaknesses relate to the lack of (1) effective controls over the financial reporting process due to an insufficient complement of personnel with a level of accounting knowledge, experience and training in the application of generally accepted accounting principles commensurate with our financial reporting requirements, and (2) an effective control environment based on criteria established in the Internal Control—Integrated Framework. Because of these material weaknesses, management was unable to conclude that we maintained effective internal control over financial reporting as of December 31, 2004 based on the criteria in the Internal Control—Integrated Framework. Further, the material weaknesses identified resulted in an adverse opinion by our independent registered public accounting firm on the effectiveness of our internal control over financial reporting.

If we are unable to substantially improve our internal controls, our ability to report our financial results on a timely and accurate basis will continue to be adversely affected, which could have a material adverse affect on our ability to operate our business. Please see Item 9A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2004 for more information regarding the measures we have commenced to implement, and which we intend to implement during the course of 2005 and 2006, which are designed to remediate the deficiencies in our internal controls described in our Management's Report On Internal Control Over Financial Reporting set forth on page F-2 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2004. The costs of remediating such deficiencies in our internal controls will adversely affect our financial condition and results of operations. In addition, even after the remedial measures discussed in Item 9A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2004 are fully implemented, our internal controls will not prevent all potential error and fraud, because any control system, no matter how well designed, can only provide reasonable and not absolute assurance that the objectives of the control system will be achieved.

The impact of ongoing purported class action, derivative and other litigation may be material. We are also subject to the risk of additional litigation and regulatory action in connection with the restatement of our consolidated financial statements and the potential liability from any such litigation or regulatory action could harm our business.

We recently restated our consolidated financial statements for the full 2002 fiscal year, the full 2003 fiscal year, the first, second and third fiscal quarters of 2003, and the first and second fiscal quarters of 2004. We, and a present and a former director and certain former officers, are defendants in certain purported class action litigations pending in the United States District Court for the Central District of California. The claims were brought on behalf of our stockholders who purchased shares during the period July 24, 2003 through October 21, 2004. The claims in all of these purported class actions were virtually identical, and purported to allege violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In this regard, the plaintiffs allege that we misrepresented and omitted material facts with respect to our financial results and operations during the time period between July 24, 2003 and October 20, 2004. The complaint sought unspecified compensatory damages, and attorneys' fees and costs, as well as accountants' and experts' fees.

On January 28, 2005, the court ordered the consolidation of the currently pending class actions into a single case pursuant to a stipulation for consolidation signed by all parties. On March 14, 2005, the court appointed a lead plaintiff and approved the selection of lead counsel and liaison counsel. On June 30, 2005, the lead plaintiff filed and served a Consolidated Amended Class Action Complaint. The putative class period is July 24, 2003 to October 21, 2004. Defendants filed and served a motion to dismiss the Consolidated Amended Class Action Complaint on August 1, 2005. The hearing is currently set for January 2006. Additional lawsuits asserting the same or similar claims may be filed as well. We intend to defend the claims vigorously. However, we cannot currently predict the impact or outcome of this litigation, which could be material, and the initiation, continuation and outcome of these lawsuits may have a material impact on our results of operations and financial condition.

In addition, our present directors and a former director and certain former officers are defendants in a derivative suit pending in the Superior Court of Orange County, California, and we are named as a nominal defendant in this suit. This suit purports to allege that the defendants breached numerous duties to us, including breach of fiduciary duty and misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment, as well as violations of California Corporations Code 25402 (trading with material non-public information), and that these breaches and violations caused losses to us, including damages to our reputation and goodwill. Plaintiffs' claims are based on allegations that the defendants disseminated false and misleading statements concerning our results of operations and that these results were inflated at all relevant times due to violations of generally accepted accounting principles and Securities and Exchange Commission rules. The complaint seeks unspecified compensatory damages, treble damages, equitable and/or injunctive relief, restitution, and attorneys' fees and costs, as well as accountants' and experts' fees. Plaintiffs filed and served an Amended Derivative Complaint on July 29, 2005. Defendants filed and served a motion to stay and a demurrer in October 2005. We intend to defend this suit vigorously. However, we cannot currently predict the impact or outcome of this litigation, which could be material, and the continuation and outcome of this lawsuit, as well as the initiation of similar suits may have a material impact on our results of operations and financial condition.

On October 21, 2005, we received a complaint as well as a demand for arbitration/statement of claim filed by certain former shareholders of Stoneage Corporation ("Stoneage"). The complaint was filed in the Central District of California and names us as well as certain current and former officers and directors as defendants. The demand for arbitration was filed with the American Arbitration Association and names the same group of defendants. The allegations and claims in both of these matters are virtually identical, and stem from the acquisition of Stoneage by us on April 15, 2004. Both the complaint and demand for arbitration contain causes of action for: breach of the acquisition agreement, breach of the registration rights agreement, violations of California Corporations Code Sections 25401 and 25501, violations of California Corporations Code Sections 25400 and 25500, fraud, negligent misrepresentation, fraudulent concealment, and violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The demand for arbitration also contains a cause of action for violation of Section 17(a) of the Securities Act of 1933. The complaint and demand for arbitration seek unspecified damages and attorneys' fees and costs, as well as rescission and punitive awards. The defendants have not responded to either the complaint or demand for arbitration. We intend to defend these claims vigorously. We cannot currently predict the outcome of this litigation, which, depending on the outcome, may have a material impact on our results of operations, financial condition or cash flows.

As a result of the restatement of our consolidated financial statements described above, we could become subject to additional purported class action, derivative, or other securities litigation. In addition, regulatory agencies, such as the Securities and Exchange Commission, could commence an investigation relating to the restatement of our consolidated financial statements. As of the date hereof, we are not aware of any additional litigation or investigation having been commenced against us related to these matters, but we cannot predict whether any such litigation or regulatory investigation will be commenced or, if it is, the outcome of any such litigation or investigation. If any such investigation were to result in a regulatory proceeding or action against us, our business and financial condition could be harmed. The initiation of any additional securities litigation, together with the lawsuits described above, may also harm our business and financial condition.

Until the existing purported class action and derivative litigation or any additional litigation or regulatory investigation are resolved, it may be more difficult for us to raise additional capital or incur indebtedness or other obligations. If an unfavorable result occurred in any such action, our business and financial condition could be further harmed.

We will incur substantial expenses in connection with ongoing purported class action, derivative and other litigation and possible related regulatory investigations which will materially and adversely affect our financial condition, results of operations, and cash flows.

We will incur substantial expenses in connection with purported class action, derivative and other litigation and possible related regulatory investigations in connection with the restatement of our consolidated financial statements, including substantial fees for attorneys and other professional advisors. We are also obligated to indemnify our current and former officers and directors named as defendants in such actions. These expenses, to the extent not covered by available insurance, will materially and adversely affect our financial condition, results of operations, and cash flows.

We will incur substantial expenses relating to remediation of material weaknesses in our internal controls identified in our internal review related to the restatement of our consolidated financial statements for certain prior periods, which will materially and adversely affect our financial condition, results of operations, and cash flows.

We will incur substantial expenses relating to the remediation of material weaknesses in our internal controls identified in our internal review related to the restatement of our consolidated financial statements for the full 2002 fiscal year, the first, second, and third fiscal quarters of 2003, the full 2003 fiscal year, and the first and second fiscal quarters of 2004. These expenses will materially and adversely affect our financial condition, results of operations, and cash flows.

Our failure to comply with certain conditions required for our common stock to be listed on The Nasdaq National Market could result in the delisting of our common stock from The Nasdaq National Market.

As a result of our failure to timely file our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2004, our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2005, and certain required restatements of our financial statements for prior periods, from November 2004 to May 2005 we were not in full compliance with Nasdaq Marketplace Rule 4310(c)(14), which requires us to make, on a timely basis, all filings with the Securities and Exchange Commission required by the Securities Exchange Act of 1934, as amended. We are required to comply with Nasdaq Marketplace Rule 4310(c)(14) as a condition for our common stock to continue to be listed on The Nasdaq National Market.

We are currently in compliance with Nasdaq Marketplace Rule 4310(c)(14) and all other conditions to continued listing on The Nasdaq National Market. However, as a result of our prior failure to comply, our continued listing is conditioned on us timely filing all periodic reports with the Securities and Exchange Commission and The Nasdaq Stock Market for all reporting periods ending on or before December 31, 2006. The filing of a Form 12b-25 extension request will not result in an automatic extension of these filing deadlines.

If we are unable to comply with the conditions for continued listing, then our shares of common stock are subject to immediate delisting from The Nasdaq National Market. If our shares of common stock are delisted from The Nasdaq National Market, they may not be eligible to trade on any national securities exchange or the over-the-counter market. If our common stock is no longer traded through a market system, it may not be liquid, which could affect its price. In addition, we may be unable to obtain future equity financing, or use our common stock as consideration for mergers or other business combinations. We intend to appeal any decision to delist our shares from The Nasdaq National Market, but cannot provide any assurance that our appeal will be successful. Any such appeal will not stay the decision to delist our shares.

If our dealer attrition increases, our dealer networks and revenues derived from these networks may decrease.

The majority of our revenues are derived from fees paid by our networks of participating retail and enterprise dealers. A few agreements account for substantially all of our enterprise dealer relationships. From time to time, a major dealer group or automotive manufacturer may significantly increase or decrease the number of enterprise dealers participating in our dealer networks or the number of purchase requests accepted from us. If dealer attrition increases or the number of purchase requests accepted from us decreases and we are unable to add new dealers to mitigate the attrition or decrease in number of accepted requests, our revenues will decrease. A material factor affecting dealer attrition is our ability to provide dealers with high quality purchase requests at prices acceptable to dealers. High quality purchase requests are those that result in high closing ratios. Closing ratio is the ratio of the number of vehicles purchased at a dealer generated from purchase requests to the total number of purchase requests sent to that dealer. If the number of dealers in our networks declines or dealers reduce the services they receive from us, our revenues will decrease and our business, results of operations and financial condition will be materially and adversely affected. In addition, if automotive manufacturers or major dealer groups force us to decrease the fees we charge for our services, our revenues will decline which could have a material adverse effect on our business, results of operations and financial condition.

Generally, our retail dealer agreements are cancelable by either party upon 30 days notice. Participating retail dealers may terminate their relationship with us for any reason, including an unwillingness to accept our subscription terms or as a result of joining alternative marketing programs. We cannot assure that retail dealers will not terminate their agreements with us. Our business is dependent upon our ability to attract and retain qualified new and used vehicle retail dealers, major dealer groups and automotive manufacturers. In order for us to grow or maintain our dealer networks, we need to reduce our dealer attrition. We cannot assure that we will be able to reduce the level of dealer attrition, and our failure to do so could materially and adversely affect our business, results of operations and financial condition.

We may lose participating retail dealers because of the reconfiguration or elimination of exclusive dealer territories. We will lose the revenues associated with any reductions in participating retail dealers resulting from such changes.

We may reduce, reconfigure or eliminate exclusive territories currently assigned to Autobytel, CarSmart or Car.com retail dealers. If a retail dealer is unwilling to accept a reduction, reconfiguration or elimination of its exclusive territory, it may terminate its relationship with us. A retail dealer also could sue to prevent such reduction, reconfiguration or elimination, or collect damages from us. We have experienced one such lawsuit. A material decrease in the number of retail dealers participating in our networks or litigation with retail dealers could have a material adverse effect on our business, results of operations and financial condition.

We send some individual purchase requests to multiple retail dealers. As a result, we may lose participating retail dealers and may be subject to pressure on the fees we charge such dealers for such purchase requests. We will lose the revenues associated with any reductions in participating retail dealers or fees.

We send some individual purchase requests to multiple retail dealers to enhance consumer satisfaction and experience. If a retail dealer perceives such requests as having less value, it may request that fees be reduced or may terminate its relationship with us. A material decrease in the number of retail dealers participating in our networks or the fees such dealers pay us could have a material adverse effect on our business, results of operations and financial condition.

We rely heavily on our participating dealers to promote our brand value by providing high quality services to our consumers. If dealers do not provide our consumers high quality services, our brand value will diminish and the number of consumers who use our services may decline causing a decrease in our revenues.

Promotion of our brand value depends on our ability to provide consumers a high quality experience for purchasing vehicles throughout the purchasing process. If our dealers do not provide consumers with high quality service, the value of our brands could be damaged and the number of consumers using our services may decrease. We devote significant efforts to train participating retail dealers in practices that are intended to increase consumer satisfaction. Our inability to train retail dealers effectively, or the failure by participating dealers to adopt recommended practices, respond rapidly and professionally to vehicle inquiries, or sell and lease vehicles in accordance with our marketing strategies, could result in low consumer satisfaction, damage our brand names and materially and adversely affect our business, results of operations and financial condition.

Competition could reduce our market share and harm our financial performance. Our market is competitive not only because the Internet has minimal technical barriers to entry, but also because we compete directly with other companies in the offline environment.

Our vehicle purchasing services compete against a variety of Internet and traditional vehicle purchasing services, automotive brokers and classified advertisement providers. Therefore, we are affected by the competitive factors faced by both Internet commerce companies as well as traditional, offline companies within the automotive and automotive-related industries. The market for Internet-based commercial services is relatively new. Competition has increased significantly in 2005. Our business is characterized by minimal technical barriers to entry, and new competitors can launch a competitive service at relatively low cost. To compete successfully, we must significantly increase awareness of our services and brand names and deliver satisfactory value to our customers. Failure to compete successfully will cause our revenues to decline and would have a material adverse effect on our business, results of operations and financial condition.

We compete with other entities which maintain similar commercial Web sites including AutoNation's AutoUSA, Microsoft Corporation's MSN Autos, CarsDirect.com, Cars.com, eBayMotors.com, Dealix.com, and AutoTrader.com. We also compete with vehicle dealers. Such companies, including vehicle dealers, may already maintain or may introduce Web sites which compete with ours. We also compete indirectly against vehicle brokerage firms and affinity programs offered by several companies, including Costco Wholesale Corporation and Wal-Mart Stores, Inc. In addition, all major automotive manufacturers have their own Web sites and many have launched online buying services, such as General Motors Corporation's BuyPower and Ford Motor Company in its partnership with its dealers through FordDirect.com. The Web Control product competes with products from companies such as Reynolds and Reynolds and Cobalt Systems Corporation. Our customer relationship management product, RPM, competes with companies that provide marketing services to automotive manufacturers and dealers, including Reynolds and Reynolds, TVI Inc., Minacs, Online Administrators and Teletech.

We believe that the principal competitive factors in the online market are:

- brand recognition,
- dealer return on investment,
- lead quality,
- prices of products and services,
- speed and quality of fulfillment,
- field sales and customer support,
- dealer territorial coverage,
- relationships with automotive manufacturers,
- variety of integrated products and services,
- ease of use,
- customer satisfaction,
- quality of Web site content,
- quality of service, and
- technical expertise.

We cannot assure that we can compete successfully against current or future competitors, many of which have substantially more capital, existing brand recognition, resources and access to additional financing. In addition, competitive pressures may result in increased marketing costs, decreased Web site traffic or loss of market share or otherwise may materially and adversely affect our business, results of operations and financial condition.

Our quarterly financial results are subject to significant fluctuations which may make it difficult for investors to predict our future performance.

Our quarterly operating results have fluctuated in the past and may fluctuate in the future due to many factors. Our expense levels are based in part on our expectations of future revenues which may vary significantly. If revenues do not increase faster than expenses, our business, results of operations and financial condition will be materially and adversely affected. Other factors that may adversely affect our quarterly operating results include:

- our ability to retain existing dealers, attract new dealers and maintain dealer and customer satisfaction,
- the announcement or introduction of new or enhanced sites, services and products by us or our competitors,
- general economic conditions and economic conditions specific to the Internet, online commerce or the automotive industry,
- a decline in the usage levels of online services and consumer acceptance of the Internet and commercial online services for the purchase of consumer products and services such as those offered by us,
- our ability to upgrade and develop our systems and infrastructure and to attract new personnel in a timely and effective manner,
- the level of traffic on our Web sites and other sites that refer traffic to our Web sites,
- technical difficulties, system downtime, Internet brownouts or electricity blackouts,
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure, and our participation in an annual trade show,
- costs relating to remediation of material weaknesses in internal controls identified in our internal review,
- costs of ongoing litigation and any adverse judgments resulting from such litigation,
- costs of defending and enforcing our intellectual property rights,
- governmental regulation, and
- unforeseen events affecting the industry.

Seasonality is likely to cause fluctuations in our operating results. Investors may not be able to predict our annual operating results based on a quarter to quarter comparison of our operating results.

The seasonal patterns of Internet usage and vehicle purchasing do not completely overlap. Historically, Internet usage typically declines during summer and certain holiday periods, while vehicle purchasing in the United States is strongest in the spring and summer months. In addition, purchase request volume usually declines in the summer because of the model year change over, as some consumers defer purchases until information regarding the new model year is available, and many manufacturers do not make their data available for publication until later in the year. As seasonality occurs, investors may not be able to predict our annual operating results based on a quarter to quarter comparison of our operating results. Seasonality in the automotive industry, Internet and commercial online service usage and advertising expenditures is likely to cause fluctuations in our operating results and could have a material adverse effect on our business, results of operations and financial condition.

Employee pricing and other actions by manufacturers that promote transparent pricing may decrease the perceived value of our services to consumers and dealers. If the number of consumers and dealers who use our services declines, our revenues will decrease.

In the summer of 2005, some manufacturers introduced programs allowing all consumers to purchase new vehicles at prices offered to employees. Employee pricing and future actions by manufacturers that promote transparent pricing may negatively affect the perceived value of our services to consumers and dealers. A decline in the perceived value of our services to consumers and dealers may result in a decline in demand for our services, which could adversely affect our business, financial condition and results of operations.

We may be particularly affected by general economic conditions due to the nature of the automotive industry.

The economic strength of the automotive industry significantly impacts the revenues we derive from dealers, automotive manufacturers and other strategic partners, advertising revenues and consumer traffic to our Web sites. The automotive industry is cyclical, with vehicle sales fluctuating due to changes in national and global economic forces. Purchases of vehicles are typically discretionary for consumers and may be particularly affected by negative trends in the general economy. The success of our operations depends to a significant extent upon a number of factors relating to discretionary consumer spending, including economic conditions (and perceptions of such conditions by consumers) affecting disposable consumer income (such as employment, wages and salaries, business conditions, energy prices and interest rates in regional and local markets). Because the purchase of a vehicle is a significant investment and is relatively discretionary, any reduction in disposable income in general or a general increase in interest rates, energy prices or a general tightening of lending may affect us more significantly than companies in other industries. In addition, if any of our larger customers were to become insolvent because of economic conditions in the automotive industry, our business, results of operations and financial condition may be materially and adversely affected.

Zero percent financing and other incentives offered by manufacturers in 2003 and 2004 and employee pricing offered to all consumers by some manufacturers in 2005 may negatively affect vehicle sales in 2005 and 2006, respectively. Consumers may have accelerated their planned vehicle purchases from 2005 to 2004 and 2003 and from 2006 to 2005. At some point in the future, manufacturers may decrease current levels of incentive spending on new vehicles, which has served to drive sales volume in the past. Such a reduction in incentives could lead to a decline in demand for new vehicles. A decline in vehicle purchases may result in a decline in demand for our services which could adversely affect our business, financial condition and results of operations.

Threatened terrorist acts and the ongoing military action have created uncertainties in the automotive industry and domestic and international economies in general. These events may have an adverse impact on general economic conditions, which may reduce demand for vehicles and consequently our services and products which could have an adverse effect on our business, financial condition and results of operations. At this time, however, we are not able to predict the nature, extent and duration of these effects on overall economic conditions on our business, financial condition and results of operations.

We cannot assure that our business will not be materially adversely affected as a result of an industry or general economic downturn.

If any of our relationships with Internet search engines or online automotive information providers terminates, our purchase request volume or quality could decline. If our purchase request volume or quality declines, our participating dealers may not be satisfied with our services and may terminate their relationships with us or force us to decrease the fees we charge for our services. If this occurs, our revenues would decrease.

We depend on a number of strategic relationships to direct a substantial amount of purchase requests and traffic to our Web sites. The termination of any of these relationships or any significant reduction in traffic to Web sites on which our services are advertised or offered, or the failure to develop additional referral sources, could cause our purchase request volume or quality to decline. If this occurs, dealers may no longer be satisfied with our services and may terminate their relationships with us or force us to decrease the fees we charge for our services. If dealers terminate their relationships with us or force us to decrease the fees we charge for our services, our revenues will decline which could have a material adverse effect on our business, results of operations and financial condition. We receive a significant number of purchase requests through a limited number of Internet search engines, online automotive information providers, and other auto related Internet sites. We periodically negotiate revisions to existing agreements and these revisions could increase our costs in future periods. A number of our agreements with online service providers may be terminated without cause. We may not be able to maintain our relationship with our online service providers or find alternative, comparable marketing sponsorships and alliances capable of originating significant numbers of purchase requests on terms satisfactory to us. If we cannot maintain or replace our relationships with online service providers, our revenues may decline which could have a material adverse effect on our business, results of operations and financial condition.

If any of our relationships with advertising manufacturers terminates, our revenues would decrease.

We depend on a number of manufacturer relationships for substantially all of our advertising revenues. The termination of any of these relationships or any significant failure to develop additional sources of advertising would cause our revenues to decline which could have a material adverse effect on our business, results of operations and financial condition. We periodically negotiate revisions to existing agreements and these revisions could decrease our advertising revenues in future periods. A number of our agreements with such manufacturers may be terminated without cause. We may not be able to maintain our relationship with such manufacturers on favorable terms or find alternative comparable relationships capable of replacing advertising revenues on terms satisfactory to us. If we cannot do so, our revenues would decline which could have a material adverse effect on our business, results of operations and financial condition.

If we cannot build and maintain strong brand loyalty our business may suffer.

We believe that the importance of brand recognition will increase as more companies engage in commerce over the Internet. Development and awareness of the Autobytel.com, Autoweb.com, Car.com, CarSmart.com and other brands will depend largely on our ability to obtain a leadership position in Internet commerce. If dealers and manufacturers do not perceive us as an effective channel for increasing vehicle sales, or consumers do not perceive us as offering reliable information concerning new and used vehicles, as well as referrals to high quality dealers, in a user-friendly manner that reduces the time spent for vehicle purchases, we will be unsuccessful in promoting and maintaining our brands. Our brands may not be able to gain widespread acceptance among consumers or dealers. Our failure to develop our brands sufficiently would have a material adverse effect on our business, results of operations and financial condition.

If we lose our key personnel or are unable to attract, train and retain additional highly qualified sales, marketing, managerial and technical personnel, our business may suffer.

Our future success depends on our ability to identify, hire, train and retain highly qualified sales, marketing, managerial and technical personnel. In addition, as we introduce new services we may need to hire additional personnel. We may not be able to attract, assimilate or retain such personnel in the future. The inability to attract and retain the necessary managerial, technical, sales and marketing personnel could have a material adverse effect on our business, results of operations and financial condition.

Our business and operations are substantially dependent on the performance of our executive officers and key employees. The loss of the services of one or more of our executive officers or key employees could have a material adverse effect on our business, results of operations and financial condition.

We are a relatively new business in an emerging industry and need to manage our growth and our entry into new business areas in order to avoid increased expenses without corresponding revenues.

We have been introducing new services to consumers and dealers in order to establish ourselves as a leader in the evolving market for automotive marketing services. Introducing new or enhanced products and services requires us to increase expenditures before we generate revenues. For example, we may need to hire personnel to oversee the introduction of new services before we generate revenues from these services. Our inability to generate satisfactory revenues from such expanded services to offset costs could have a material adverse effect on our business, results of operations and financial condition.

We must also:

- test, introduce and develop new services and products, including enhancing our Web sites,
- expand the breadth of products and services offered,
- expand our market presence through relationships with third parties, and
- acquire new or complementary businesses, products or technologies.

We cannot assure that we can successfully achieve these objectives.

If federal or state franchise laws apply to us we may be required to modify or eliminate our marketing programs. If we are unable to market our services in the manner we currently do, our revenues may decrease and our business may suffer.

We believe that neither our relationship with our dealers nor our dealer subscription agreements constitute “franchises” under federal or state franchise laws. A federal court of appeals in Michigan has ruled that our dealer subscription agreement is not a “franchise” under Michigan law. However, if any state’s regulatory requirements relating to franchises or our method of business impose additional requirements on us or include us within an industry-specific regulatory scheme, we may be required to modify our marketing programs in such states in a manner which undermines the program's attractiveness to consumers or dealers. If our relationship or written agreement with our dealers were found to be a "franchise" under federal or state franchise laws, we could be subject to other regulations, such as franchise disclosure and registration requirements and limitations on our ability to effect changes in our relationships with our dealers, which may negatively impact our ability to compete and cause our revenues to decrease and our business to suffer. If we become subject to fines or other penalties or if we determine that the franchise and related requirements are overly burdensome, we may elect to terminate operations in such state. In each case, our revenues may decline and our business, results of operations and financial condition could be materially and adversely affected.

We also believe that our dealer marketing service generally does not qualify as an automobile brokerage activity and, therefore, state motor vehicle dealer or broker licensing requirements do not apply to us. Through a subsidiary, we are licensed as a motor vehicle dealer and broker. In response to Texas Department of Transportation concerns, we modified our marketing program in that state to make our program open to all dealers who wish to apply. In addition, we modified the program to include a pricing model under which all participating dealers, regardless of brand, in a given zip code in Texas are charged uniform fees. If other states' regulatory requirements relating to motor vehicle dealers or brokers are deemed applicable to us, we may become subject to fines, penalties or other requirements and may be required to modify our marketing programs in such states in a manner that undermines the attractiveness of the program to consumers or dealers. If we determine that the licensing or other requirements, in a given state are overly burdensome, we may elect to terminate operations in such state. In each case, our revenues may decline and our business, results of operations and financial condition could be materially and adversely affected.

If financial broker and insurance licensing requirements apply to us in states where we are not currently licensed, we will be required to obtain additional licenses and our business may suffer.

If we are required to be licensed as a financial broker, it may result in an expensive and time-consuming process that could divert the effort of management away from day-to-day operations. In the event states require us to be licensed and we are unable to do so, or are otherwise unable to comply with regulations required by changes in current operations or the introduction of new services, we could be subject to fines or other penalties or be compelled to discontinue operations in such states, and our business, results of operations and financial condition could be materially and adversely affected.

We provide links on our Web sites so consumers can receive real time quotes for insurance coverage from third parties and submit quote applications online through such parties' Web sites. We receive fees from such participants in connection with this advertising activity. We do not believe that such activities require us to be licensed under state insurance laws. The use of the Internet in the marketing of insurance products, however, is a relatively new practice. It is not clear whether or to what extent state insurance licensing laws apply to activities similar to ours. Given these uncertainties, we currently hold, through a wholly-owned subsidiary, insurance agent licenses or are otherwise authorized to transact insurance in numerous states.

If we are unable to be licensed to comply with additional regulations, or are otherwise unable to comply with regulations required by changes in current operations or the introduction of new services, we could be subject to fines or other penalties or be compelled to discontinue operations in such states, and our business, results of operations and financial condition could be materially and adversely affected.

There are many risks associated with consummated and potential acquisitions.

We may evaluate potential acquisitions which we believe will complement or enhance our existing business. If we acquire other companies in the future, it may dilute the value of existing stockholders' ownership. The impact of dilution may restrict our ability or otherwise not allow us to consummate acquisitions. Issuance of equity securities may restrict utilization of net operating loss carryforwards because of an annual limitation due to ownership change limitations under the Internal Revenue Code. We may also incur debt and losses related to the impairment of goodwill and acquired intangible assets if we acquire another company, and this could negatively impact our results of operations. We currently do not have any definitive agreements to acquire any company or business, and we may not be able to identify or complete any acquisition in the future.

Acquisitions involve numerous risks. For example:

- It may be difficult to assimilate the operations and personnel of an acquired business into our own business,

- Management information and accounting systems of an acquired business must be integrated into our current systems,
- We may lose dealers participating in both our network as well as that of the acquired business, if any,
- Our management must devote its attention to assimilating the acquired business which diverts attention from other business concerns,
- We may enter markets in which we have limited prior experience, and
- We may lose key employees of an acquired business.

Internet commerce has yet to attract significant regulation. Government regulations may result in increased costs that may reduce our future earnings.

There are currently few laws or regulations that apply directly to the Internet. Because our business is dependent on the Internet, the adoption of new local, state or national laws or regulations may decrease the growth of Internet usage or the acceptance of Internet commerce which could, in turn, decrease the demand for our services and increase our costs or otherwise have a material adverse effect on our business, results of operations and financial condition.

Tax authorities in a number of states are currently reviewing the appropriate tax treatment of companies engaged in Internet commerce. New state tax regulations may subject us to additional state sales, use and income taxes.

Evolving government regulations may require future licensing which could increase administrative costs or adversely affect our revenues.

In a regulatory climate that is uncertain, our operations may be subject to direct and indirect adoption, expansion or reinterpretation of various laws and regulations. Compliance with these future laws and regulations may require us to obtain appropriate licenses at an undeterminable and possibly significant initial monetary and annual expense. These additional monetary expenditures may increase future overhead, thereby potentially reducing our future results of operations.

We have identified what we believe are the areas of domestic government regulation, which if changed, would be costly to us. These laws and regulations include franchise laws, motor vehicle brokerage licensing laws, motor vehicle dealer licensing laws, insurance licensing laws and financial services laws, which are or may be applicable to aspects of our business. There could be laws and regulations applicable to our business which we have not identified or which, if changed, may be costly to us.

Our success is dependent on keeping pace with advances in technology. If we are unable to keep pace with advances in technology, consumers may stop using our services and our revenues will decrease. If we are required to invest substantial amounts in technology, our results of operations will suffer.

The Internet and electronic commerce markets are characterized by rapid technological change, changes in user and customer requirements, frequent new service and product introductions embodying new technologies and the emergence of new industry standards and practices that could render our existing Web sites and technology obsolete. These market characteristics are exacerbated by the emerging nature of the market and the fact that many companies are expected to introduce new Internet products and services in the near future. If we are unable to adapt to changing technologies, our business, results of operations and financial condition could be materially and adversely affected. Our performance will depend, in part, on our ability to continue to enhance our existing services, develop new technology that addresses the increasingly sophisticated and varied needs of our prospective customers, license leading technologies and respond to technological advances and emerging industry standards and practices on a timely and cost-effective basis. The development of our Web sites and CRM systems and other proprietary technology entails significant technical and business risks. We may not be successful in using new technologies effectively or adapting our Web sites and CRM systems, or other proprietary technology to customer requirements or to emerging industry standards. In addition, if we are required to invest substantial amounts in technology in order to keep pace with technological advances, our results of operations will suffer.

We are vulnerable to electricity blackouts and communications system interruptions. The majority of our primary servers are located in a single location. If electricity or communications to that location or to our headquarters were interrupted, our operations would be adversely affected.

With the exception of the ADS production servers and certain related systems, our production Web sites and certain systems, including Autobytel.com, Autoweb.com, CarSmart.com, AutoSite.com, Car.com, Finance.Car.com, AVV.com, iDriveonline and RPM are currently hosted at secure third-party hosting facilities. We host the ADS production servers at AVV's facilities. Although backup servers are available, our primary servers are vulnerable to interruption by damage from fire, earthquake, flood, power loss, telecommunications failure, break-ins and other events beyond our control. In the event that we experience significant system disruptions, our business, results of operations and financial condition would be materially and adversely affected. We have, from time to time, experienced periodic systems interruptions and anticipate that such interruptions will occur in the future.

Our main production systems and our accounting, finance and contract management systems are hosted in secure facilities with generators and other alternate power supplies in case of a power outage. However, our corporate offices, where we have the users and limited applications for our accounting, finance and contract management systems, are vulnerable to wide-scale power outages. To date, we have not been significantly affected by blackouts or other interruptions in service. In the event we are affected by interruptions in service, our business, results of operations and financial condition could be materially and adversely affected.

We maintain business interruption insurance which pays up to $8.6 million for the actual loss of business income sustained due to the suspension of operations as a result of direct physical loss of or damage to property at our offices. However, in the event of a prolonged interruption, this business interruption insurance may not be sufficient to fully compensate us for the resulting losses.

Internet commerce is relatively new and evolving. We cannot assure that our business model will be profitable in the future.

The market for Internet-based purchasing services has only recently begun to develop and is rapidly evolving. As is typical for a new and rapidly evolving industry, demand and market acceptance for recently introduced services and products over the Internet are subject to a high level of uncertainty and there are few proven services and products. Moreover, since the market for our services is relatively new and evolving, it is difficult to predict the future growth rate, if any, and size of this market. Accordingly, we cannot assure that our business model will be successful or that we will be profitable in the future.

If consumers do not continue to adopt Internet commerce as a mainstream medium of commerce or if automotive industry participants do not continue to accept the role of third-party online services, our revenues may not grow and our earnings may suffer.

The success of our services will continue to depend upon the adoption of the Internet by consumers and dealers as a mainstream medium for commerce and/or the willingness of automotive manufacturers to cooperate with third-party services. While we believe that our services offer significant advantages to consumers and dealers, there can be no assurance of continued acceptance of our services by consumers, dealers or automotive companies. Our success assumes that consumers and dealers who have historically relied upon traditional means of commerce to purchase or lease vehicles, and to procure vehicle financing and insurance, will continue to accept new methods of conducting business and exchanging information and that automotive manufacturers will continue to accept a role for all make, all model third-party sites such as ours that allow for comparisons. In addition, dealers must continue to adopt new selling models and be trained to use and invest in developing technologies. If the market for Internet-based vehicle marketing services fails to develop, develops slower than expected, faces opposition or becomes saturated with competitors, or if our services do not continue to be accepted, our business, results of operations and financial condition may be materially and adversely affected.

Internet-related issues may reduce or slow the growth in the use of our services in the future.

Critical issues concerning the commercial use of the Internet, such as ease of access, security, privacy, reliability, cost, and quality of service, remain unresolved and may impact the growth of Internet use. If Internet usage continues to increase rapidly, the Internet infrastructure may not be able to support the demands placed on it by this growth, and its performance and reliability may decline. The recent growth in Internet traffic has caused frequent periods of decreased performance, outages and delays. Our ability to increase the speed with which we provide services to consumers and to increase the scope and quality of such services is limited by and dependent upon the speed and reliability of the Internet, which is beyond our control. If periods of decreased performance, outages or delays on the Internet occur frequently or other critical issues concerning the Internet are not resolved, overall Internet usage or usage of our Web sites could increase more slowly or decline, which would cause our business, results of operations and financial condition to be materially and adversely affected.

The public market for our common stock may continue to be volatile, especially since market prices for Internet-related and technology stocks have often been unrelated to operating performance.

Prior to the initial public offering of our common stock in March 1999, there was no public market for our common stock. We cannot assure that an active trading market will be sustained or that the market price of the common stock will not decline. Recently, the stock market in general and the shares of emerging companies in particular have experienced significant price fluctuations. The market price of our common stock is likely to continue to be highly volatile and could be subject to wide fluctuations in response to factors such as:

- actual or anticipated variations in our quarterly operating results,
- historical and anticipated operating metrics such as the number of participating dealers, the visitors to our Web sites and the frequency with which they transact,
- announcements of new product or service offerings,
- technological innovations,
- competitive developments, including actions by automotive manufacturers,
- changes in financial estimates by securities analysts or our failure to meet such estimates,
- conditions and trends in the Internet, electronic commerce and automotive industries,
- our ability to comply with the conditions to continued listing of our stock on The Nasdaq National Market,
- adoption of new accounting standards affecting the technology or automotive industry, and
- general market conditions and other factors.

Further, the stock markets, and in particular the Nasdaq National Market, have experienced extreme price and volume fluctuations that have particularly affected the market prices of equity securities of many technology companies and have often been unrelated or disproportionate to the operating performance of such companies. These broad market factors have affected and may adversely affect the market price of our common stock. In addition, general economic, political and market conditions, such as recessions, interest rates, energy prices, international currency fluctuations, terrorist acts, military actions or wars, may adversely affect the market price of the common stock. In the past, following periods of volatility in the market price of a company’s securities, securities class action litigation has often been instituted against companies with publicly traded securities. Such litigation could result in substantial costs and a diversion of management’s attention and resources, which would have a material adverse effect on our business, results of operations and financial condition.

Changing legislation affecting the automotive industry could require increased regulatory and lobbying costs and may harm our business.

Our services may result in changing the way vehicles are sold which may be viewed as threatening by new and used vehicle dealers who do not subscribe to our programs. Such businesses are often represented by influential lobbying organizations, and such organizations or other persons may propose legislation which could impact the evolving marketing and distribution model which our services promote. Should current laws be changed or new laws passed, our business, results of operations and financial condition could be materially and adversely affected. As we introduce new services, we may need to comply with additional licensing regulations and regulatory requirements.

To date, we have not spent significant resources on lobbying or related government affairs issues but we may need to do so in the future. A significant increase in the amount we spend on lobbying or related activities could have a material adverse effect on our results of operations and financial condition.

International activities may adversely affect our results of operations and financial condition.

Our licensees currently have Web sites in the United Kingdom, The Netherlands and Japan. Revenue from our licensees may be adversely affected by risks in conducting business in their markets, such as regulatory requirements, changes in political conditions, potentially weaker intellectual property protections and educating consumers and dealers who may be unfamiliar with the benefits of online marketing and commerce. In addition, our investment in licensees may be impaired. We may expand our brand into other foreign markets primarily through licensing our trade names. In the past we incurred losses in our international activities. We cannot be certain that we will be successful in introducing or marketing our services abroad. Our results of operations and financial condition may be adversely affected by our international activities.

Our computer infrastructure may be vulnerable to security breaches. Any such problems could jeopardize confidential information transmitted over the Internet, cause interruptions in our operations or cause us to have liability to third persons.

Our computer infrastructure is potentially vulnerable to physical or electronic computer break-ins, viruses and similar disruptive problems and security breaches. Any such problems or security breaches could cause us to have liability to one or more third parties and disrupt all or part of our operations. A party able to circumvent our security measures could misappropriate proprietary information, customer information or consumer information, jeopardize the confidential nature of information transmitted over the Internet or cause interruptions in our operations. Concerns over the security of Internet transactions and the privacy of users could also inhibit the growth of the Internet in general, particularly as a means of conducting commercial transactions. To the extent that our activities or those of third-party contractors involve the storage and transmission of proprietary information such as personal financial information, security breaches could expose us to a risk of financial loss, litigation and other liabilities. Our current insurance program may protect us against some, but not all, of such losses. Any of these events could have a material adverse effect on our business, results of operations and financial condition.

We depend on continued technological improvements in our systems and in the Internet overall. If we are unable to handle an unexpectedly large increase in volume of consumers using our Web sites, we cannot assure our consumers or dealers that purchase requests will be efficiently processed and our business may suffer.

If the Internet continues to experience significant growth in the number of users and the level of use, then the Internet infrastructure may not be able to continue to support the demands placed on it by such potential growth. The Internet may not continue to be a viable commercial medium because of inadequate development of the necessary infrastructure, timely development of complementary products, delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity or increased government regulation.

An unexpectedly large increase in the volume or pace of traffic on our Web sites or the number of orders placed by customers may require us to expand and further upgrade our technology, transaction-processing systems and network infrastructure. We may not be able to accurately project the rate or timing of increases, if any, in the use of our Web sites or expand and upgrade our systems and infrastructure to accommodate such increases. In addition, we cannot assure that our dealers will efficiently process purchase requests.

Any of such failures regarding the Internet in general or our Web sites, technology systems and infrastructure in particular, or with respect to our dealers, would have a material and adverse affect on our business, results of operations and financial condition.

Misappropriation of our intellectual property and proprietary rights could impair our competitive position.

Our ability to compete depends upon our proprietary systems and technology. While we rely on trademark, trade secret, patent and copyright law, confidentiality agreements and technical measures to protect our proprietary rights, we believe that the technical and creative skills of our personnel, continued development of our proprietary systems and technology, brand name recognition and reliable Web site maintenance are more essential in establishing and maintaining a leadership position and strengthening our brands. As part of our confidentiality procedures, we generally enter into confidentiality agreements with our employees and consultants and limit access to our trade secrets and technology. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our services or to obtain and use information that we regard as proprietary. Policing unauthorized use of our proprietary rights is difficult. We cannot assure that the steps taken by us will prevent misappropriation of technology or that the agreements entered into for that purpose will be enforceable. Effective trademark, service mark, patent, copyright and trade secret protection may not be available in every country in which our products and services are made available online. In addition, litigation may be necessary to enforce or protect our intellectual property rights or to defend against claims or infringement or invalidity. We filed one such lawsuit, which is currently pending, to protect our patent. Such litigation, even if successful, could result in substantial costs and diversion of resources and management attention and could materially adversely affect our business, results of operations and financial condition. Misappropriation of our intellectual property or potential litigation could also have a material adverse effect on our business, results of operations and financial condition.

We face risk of claims from third parties relating to intellectual property. In addition, we may incur liability for retrieving and transmitting information over the Internet. Such claims and liabilities could harm our business.

As part of our business, we make Internet services and content available to our customers. This creates the potential for claims to be made against us, either directly or through contractual indemnification provisions with third parties. We could face liability for information retrieved from or transmitted over the Internet and liability for products sold over the Internet. We could be exposed to liability with respect to third-party information that may be accessible through our Web sites, links or car review services. Such claims might, for example, be made for defamation, negligence, patent, copyright or trademark infringement, personal injury, breach of contract, unfair competition, false advertising, invasion of privacy or other legal theories based on the nature, content or copying of these materials. Such claims might assert, among other things, that, by directly or indirectly providing links to Web sites operated by third parties, we should be liable for copyright or trademark infringement or other wrongful actions by such third parties through such Web sites. It is also possible that, if any third-party content information provided on our Web sites contains errors, consumers could make claims against us for losses incurred in reliance on such information. Any claims could result in costly litigation, divert management's attention and resources, cause delays in releasing new or upgrading existing services or require us to enter into royalty or licensing agreements.

We also enter into agreements with other companies under which any revenue that results from the purchase of services through direct links to or from our Web sites is shared. Such arrangements may expose us to additional legal risks and uncertainties, including disputes with such parties regarding revenue sharing, local, state and federal government regulation and potential liabilities to consumers of these services, even if we do not provide the services ourselves. We cannot assure that any indemnification provided to us in our agreements with these parties, if available, will be adequate.

Even to the extent such claims do not result in liability to us, we could incur significant costs in investigating and defending against such claims. The imposition upon us of potential liability for information carried on or disseminated through our system could require us to implement measures to reduce our exposure to such liability, which might require the expenditure of substantial resources or limit the attractiveness of our services to consumers, dealers and others.

Litigation regarding intellectual property rights is common in the Internet and software industries. We expect that Internet technologies and software products and services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. There can be no assurance that our services do not infringe on the intellectual property rights of third parties.

In the past, plaintiffs have brought these types of claims and sometimes successfully litigated them against online services. Our general liability insurance may not cover all potential claims to which we are exposed and may not be adequate to indemnify us for all liability that may be imposed. Any imposition of liability that is not covered by insurance or is in excess of our insurance coverage could have a material adverse effect on our business, results of operations and financial condition.

We could be adversely affected by litigation. If we were subject to a significant adverse litigation outcome, our financial condition could be materially adversely affected.

We are a defendant in certain proceedings which are described in "Part II. Item 1. Legal Proceedings" herein.

From time to time, we are involved in other litigation matters arising from the normal course of our business activities. The actions filed against us and other litigation, even if not meritorious, could result in substantial costs and diversion of resources and management attention and an adverse outcome in litigation could materially adversely affect our business, results of operations and financial condition.

We are uncertain of our ability to obtain additional financing for our future capital needs. If we are unable to obtain additional financing we may not be able to continue to operate our business.

We currently anticipate that our cash, cash equivalents and short-term and long-term investments will be sufficient to meet our anticipated needs for working capital and other cash requirements at least for the next 12 months. We may need to raise additional funds sooner, however, in order to develop new or enhance existing services or products or to respond to competitive pressures. There can be no assurance that additional financing will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, our ability to develop or enhance services or products or respond to competitive pressures would be significantly limited. In addition, our ability to continue to operate our business may also be materially adversely affected in the event additional financing is not available when required. Such limitation could have a material adverse effect on our business, results of operations, financial condition and prospects.

Our certificate of incorporation and bylaws, stockholder rights plan and Delaware law contain provisions that could discourage a third party from acquiring us or limit the price third parties are willing to pay for our stock.

Provisions of our amended and restated certificate of incorporation and bylaws relating to our corporate governance and provisions in our stockholder rights plan could make it difficult for a third party to acquire us, and could discourage a third party from attempting to acquire control of us. These provisions allow us to issue preferred stock with rights senior to those of the common stock without any further vote or action by the stockholders. These provisions provide that the board of directors is divided into three classes, which may have the effect of delaying or preventing changes in control or change in our management because less than a majority of the board of directors are up for election at each annual meeting. In addition, these provisions impose various procedural and other requirements which could make it more difficult for stockholders to effect corporate actions such as a merger, asset sale or other change of control of us. Under the stockholder rights plan, if a person or group acquires 15% or more of our common stock, all rightsholders, except the acquiror, will be entitled to acquire at the then exercise price of a right that number of shares of Autobytel's common stock which, at the time, has a market value of two times the exercise price of the right. In addition, under certain circumstances, all rightholders, other than the acquiror, will be entitled to receive at the then exercise price of a right that number of shares of common stock of the acquiring company which, at the time, has a market value of two times the exercise price of the right. The initial exercise price of a right is $65. Such charter and rights provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock and may have the effect of delaying or preventing a change in control. The issuance of preferred stock also could decrease the amount of earnings and assets available for distribution to the holders of common stock or could adversely affect the rights and powers, including voting rights, of the holders of the common stock.

We are also subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law. In general, the statute prohibits a publicly held Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. For purposes of Section 203, a "business combination" includes a merger, asset sale or other transaction resulting in a financial benefit to the interested stockholder, and an "interested stockholder" is a person who, together with affiliates and associates, owns or did own 15% or more of the corporation's voting stock.

Our actual results could differ from forward-looking statements in this report.

This report contains forward-looking statements based on current expectations which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors, including the risk factors set forth above and elsewhere in this Quarterly Report on Form 10-Q. The cautionary statements made in this report should be read as being applicable to all forward-looking statements wherever they appear in this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to the impact of foreign currency fluctuations, and changes in the market values of our investments.

Foreign Currency Risk.

We are exposed to foreign exchange rate fluctuations as we convert the financial statements of Autobytel.Europe into U.S. dollars in consolidation. If there is a change in foreign currency exchange rates, the conversion of Autobytel.Europe's financial statements into U.S. dollars will lead to a translation gain or loss which is recorded as a component of other comprehensive income.

Investment Risk.

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of securities, including both government and corporate obligations and money market funds. As of September 30, 2005 and December 31, 2004, net unrealized losses on these investments were not material.

Item 4. ***Controls and Procedures***

As more fully described in Note 3 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, we restated our financial statements for the full 2002 fiscal year, the first, second, and third fiscal quarters of 2003, the full 2003 fiscal year, and the first and second fiscal quarters of 2004.

As described more fully in our Management's Report On Internal Control Over Financial Reporting set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2004, and this assessment identified internal control deficiencies that individually or collectively are indicative of a material weakness in our internal control over financial reporting. Management currently is implementing certain remedial measures identified in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2004, and intends to implement the remaining remedial measures during the course of 2005 and 2006. While this implementation is underway, we are relying on extensive manual procedures and the utilization of outside accounting professionals to assist us with meeting the objectives otherwise fulfilled by an effective controls environment. While we are implementing changes to our controls environment, there remains a risk that the transitional procedures on which we are currently relying will fail to be sufficiently effective to address the internal control deficiencies identified in Management's Report On Internal Control Over Financial Reporting. Please see Part I, Item 2. "Management's Discussion and Analysis—Risk Factors—Our internal controls and procedures need to be improved."

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. In light of the internal control deficiencies referenced in the Management's Report On Internal Control Over Financial Reporting, our Chief Executive Officer and our Chief Financial Officer believe that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were not effective in alerting our management, including our principal executive officer and principal financial officer, to material information required to be included in our periodic reports filed with the Securities and Exchange Commission. However, our Chief Executive Officer and our Chief Financial Officer, believe that the remedial measures described in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2004, when implemented, will be designed to address the internal control deficiencies described in the Management's Report On Internal Control Over Financial Reporting and should allow us to conclude that our disclosure controls and procedures are effective at a reasonable level of assurance at future filing dates.

As of the end of the period covered by this Quarterly Report on Form 10-Q, there were no changes in our internal control over financial reporting that have materially affected or were reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

In August 2001, a purported class action lawsuit was filed in the United States District Court for the Southern District of New York against Autobytel and certain of Autobytel's current and former directors and officers (the "Autobytel Individual Defendants") and underwriters involved in Autobytel's initial public offering. The complaints against Autobytel have been consolidated with two other complaints that relate to its initial public offering but do not name it as a defendant, and a Consolidated Amended Complaint, which is now the operative complaint, was filed on April 19, 2002. This action purports to allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Plaintiffs allege that the underwriter defendants agreed to allocate stock in Autobytel's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for Autobytel's initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The action seeks damages in an unspecified amount. The action is being coordinated with approximately 300 other nearly identical actions filed against other companies. A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Autobytel Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Autobytel Individual Defendants. On February 19, 2003, the Court denied the motion to dismiss the complaint against Autobytel. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Autobytel case. Autobytel has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autobytel, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of Autobytel and the Autobytel Individual Defendants for the conduct alleged in the action to be wrongful. Autobytel would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims Autobytel may have against its underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of Autobytel to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. Autobytel currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and Autobytel is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, we do not expect that the settlement will involve any payment by Autobytel. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from Autobytel's insurance carriers should arise, Autobytel's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and Autobytel is found liable, we are unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than our insurance coverage, or whether such damages would have a material impact on our results of operations, financial condition or cash flows in any future period.

Between April and June 2001, eight separate purported class actions virtually identical to the one filed against Autobytel were filed against Autoweb.com, Inc. ("Autoweb"), certain of Autoweb's current and former directors and officers (the "Autoweb Individual Defendants") and underwriters involved in Autoweb's initial public offering. The complaints against Autoweb have been consolidated into a single action, and a Consolidated Amended Complaint, which is now the operative complaint, was filed on April 19, 2002. The foregoing action purports to allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Plaintiffs allege that the underwriter defendants agreed to allocate stock in Autoweb's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for Autoweb's initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The action seeks damages in an unspecified amount. The action is being coordinated with approximately 300 other nearly identical actions filed against other companies. A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Autoweb Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Autoweb Individual Defendants. On February 19, 2003, the Court dismissed the Section 10(b) claim without prejudice and with leave to replead but denied the motion to dismiss the claim under Section 11 of the Securities Act of 1933 against Autoweb. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Autoweb case. Autoweb has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autoweb, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of Autoweb and the Autoweb Individual Defendants for the conduct alleged in the action to be wrongful. Autoweb would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims Autoweb may have against its underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of Autoweb to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. Autoweb currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and Autoweb is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, we do not expect that the settlement will involve any payment by Autoweb. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from Autoweb's insurance carriers should arise, Autoweb's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and Autoweb is found liable, we are unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than Autoweb's insurance coverage, or whether such damages would have a material impact on our results of operations, financial condition or cash flows in any future period.

On September 24, 2004, we filed a lawsuit in the United States District Court for the Eastern District of Texas against Dealix Corporation. In that lawsuit, we assert infringement of U.S. Patent No. 6,282,517, entitled "Real Time Communication of Purchase Requests," against Dealix Corporation. We contend that Dealix Corporation is infringing our patent by virtue of Dealix Corporation's software system for the distribution of purchase requests and seek damages and/or a preliminary injunction. Dealix Corporation filed answers to this lawsuit on January 28, 2005, February 1, 2005 and July 19, 2005, in which it asserts typical defensive counterclaims denying infringement, asserting patent misuse and challenging the validity of the patent. We filed a reply responding to such counterclaims on August 2, 2005. A Markman Hearing, to construe the individual terms of the asserted patent's claims prior to a determination of infringement, was held in October, 2005. Dealix Corporation also seeks attorney's fees and costs. We expect to incur attorneys' fees and costs in this matter as are customary in the prosecution of patent litigation, and could be liable for Dealix Corporation's attorneys' fees and costs if Dealix Corporation is successful in its counterclaims.

Between October and December 2004, five separate purported class actions were filed in the United States District Court for the Central District of California against us and certain of our current directors and current and former officers. The claims were brought on behalf of stockholders who purchased shares during the period July 24, 2003 through October 21, 2004. The claims alleged in all of these purported class actions were virtually identical, and purported to allege violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In this regard, the plaintiffs allege that we misrepresented and omitted material facts with respect to our financial results and operations during the time period between July 24, 2003 and October 20, 2004. The complaint sought unspecified compensatory damages, and attorneys' fees and costs, as well as accountants' and experts' fees.

On January 28, 2005, the court ordered the consolidation of the currently pending class actions into a single case pursuant to a stipulation for consolidation signed by all parties. On March 14, 2005, the court appointed a lead plaintiff and approved the selection of lead counsel and liaison counsel. On June 30, 2005, the lead plaintiff filed and served a Consolidated Amended Class Action Complaint alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The putative class period is July 24, 2003 to October 21, 2004. Defendants filed and served a motion to dismiss the Consolidated Amended Class Action Complaint on August 1, 2005. The hearing is currently set for January 2006. Additional lawsuits asserting the same or similar claims may be filed as well. We intend to defend the claims vigorously. However, we cannot currently predict the impact or outcome of this litigation, which could be material, and the initiation, continuation and outcome of these lawsuits may have a material impact on our results of operations, financial condition or cash flows.

In addition, our directors and a former officer are defendants in a derivative suit pending in the Superior Court of Orange County, California, and we are named as a nominal defendant in this suit. This suit purports to allege that the defendants breached numerous duties to us, including breach of fiduciary duty and misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment, as well as violations of California Corporations Code 25402 (trading with material non-public information), and that these breaches and violations caused losses to us, including damages to our reputation and goodwill. Plaintiffs' claims are based on allegations that the defendants disseminated false and misleading statements concerning our results of operations and that these results were inflated at all relevant times due to violations of generally accepted accounting principles and Securities and Exchange Commission rules. The complaint seeks unspecified compensatory damages, treble damages, equitable and/or injunctive relief, restitution, and attorneys' fees and costs, as well as accountants' and experts' fees. Plaintiffs filed and served an Amended Derivative Complaint on July 29, 2005. Defendants filed and served a motion to stay and a demurrer in October 2005. We intend to defend this suit vigorously. However, we cannot currently predict the impact or outcome of this litigation, which could be material, and the continuation and outcome of this lawsuit, as well as the initiation of similar suits may have a material impact on our results of operations, financial condition or cash flows.

On October 21, 2005, we received a complaint as well as a demand for arbitration/statement of claim filed by certain former shareholders of Stoneage Corporation ("Stoneage"). The complaint was filed in the Central District of California and names us as well as certain current and former officers and directors as defendants. The demand for arbitration was filed with the American Arbitration Association and names the same group of defendants. The allegations and claims in both of these matters are virtually identical, and stem from the acquisition of Stoneage by us on April 15, 2004. Both the complaint and demand for arbitration contain causes of action for: breach of the acquisition agreement, breach of the registration rights agreement, violations of California Corporations Code Sections 25401 and 25501, violations of California Corporations Code Sections 25400 and 25500, fraud, negligent misrepresentation, fraudulent concealment, and violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The demand for arbitration also contains a cause of action for violation of Section 17(a) of the Securities Act of 1933. The complaint and demand for arbitration seek unspecified damages and attorneys' fees and costs, as well as rescission and punitive awards. The defendants have not responded to either the complaint or demand for arbitration. We intend to defend these claims vigorously. We cannot currently predict the outcome of this litigation, which, depending on the outcome, may have a material impact on our results of operations, financial condition or cash flows.

We have reviewed the above class, derivative and other actions and do not believe that it is probable that a loss contingency has occurred, therefore, no amounts have been recorded in the accompanying consolidated financial statements.

From time to time, we are involved in other litigation matters arising from the normal course of our business activities. The actions filed against us and other litigation, even if not meritorious, could result in substantial costs and diversion of resources and management attention and an adverse outcome in litigation could materially adversely affect our business, results of operations, financial condition or cash flows.

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

We held our Annual Meeting of Stockholders on September 8, 2005. The following is a brief description of the matter voted upon at the meeting and the number of votes cast for or withheld with respect to such matter. Each director proposed by us was elected.

The stockholders reelected the two nominees for our board of directors:

Director	For	Withheld Authority
Jeffrey H. Coats	35,266,276	1,169,417
Mark R. Ross	36,012,647	423,046

The term of office as director for Mark N. Kaplan, Richard A. Post, Michael J. Fuchs and Robert S. Grimes continued after the meeting.

Item 6. ***Exhibits***

10.1	Employment Agreement, dated July 19, 2005, between Autobytel Inc. and Ariel Amir is incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on July 22, 2005.
10.2	Form of Outside Director Stock Option Agreement under 2004 Restricted Stock and Option Plan is incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on September 14, 2005.
10.3	Form of Letter Agreement (amending stock option agreement) is incorporated herein by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on September 14, 2005.
31.1	Chief Executive Officer Section 302 Certification of Periodic Report, dated November 7, 2005.
31.2	Chief Financial Officer Section 302 Certification of Periodic Report, dated November 7, 2005.
32.1	Chief Executive Officer and Chief Financial Officer Section 906 Certification of Periodic Report, dated November 7, 2005.

Table of Contents

SIGNATURES

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

AUTOBYTEL INC.

By: /s/ MICHAEL F. SCHMIDT

Michael F. Schmidt
Chief Financial Officer
(Duly Authorized Officer, Principal Financial Officer, and Principal Accounting Officer)

Date: November 7, 2005

Table of Contents

EXHIBIT INDEX

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Exhibit 31.1

CERTIFICATION

I, Richard A. Post, President and Chief Executive Officer of Autobytel Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Autobytel Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2005

/s/ RICHARD A. POST

Richard A. Post,
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Michael F. Schmidt, Chief Financial Officer of Autobytel Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Autobytel Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15 (f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2005

/s/ MICHAEL F. SCHMIDT

Michael F. Schmidt,
Chief Financial Officer (Principal Financial Officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Autobytel Inc. (the " *Company* ") on Form 10-Q for the period ended September 30, 2005 (the " *Report* "), we, Richard A. Post, Chief Executive Officer of the Company, and Michael F. Schmidt, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ RICHARD A. POST

Richard A. Post,
Chief Executive Officer
November 7, 2005

/s/ MICHAEL F. SCHMIDT

Michael F. Schmidt,
Chief Financial Officer (Principal Financial Officer)
November 7, 2005

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signatures that appear in typed form within the electronic version of this written statement required by Section 906, has been provided to Autobytel Inc. and will be retained by Autobytel Inc. and furnished to the Securities and Exchange Commission or its staff upon request.