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 June 30, 2003

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 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 ☐

As of July 31, 2003, there were 37,058,544 shares of the Registrant's Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

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

AUTOBYTEL INC.

CONSOLIDATED BALANCE SHEETS
(Dollar amounts in thousands, except share and per share data)

	June 30, 2003	December 31, 2002
ASSETS	(unaudited)	
Current assets:		
Cash and cash equivalents	$ 51,733	$ 27,571
Accounts receivable, net of allowance for doubtful accounts and customer credits of $4,334 and $4,214, respectively	8,251	6,757
Prepaid expenses and other current assets	1,984	3,495
Total current assets	61,968	37,823
Property and equipment, net	2,021	2,088
Capitalized software, net	1,564	2,105
Investment in unconsolidated subsidiary	4,812	4,745
Goodwill	16,839	8,367
Other assets	488	96
Total assets	$ 87,692	$ 55,224
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,115	$ 3,529
Accrued expenses	4,387	4,795
Deferred revenues	3,641	3,575
Customer deposits	—	76
Accrued restructuring—current	177	223
Capital lease obligations—current	99	—
Other current liabilities	397	349
Total current liabilities	12,816	12,547
Accrued restructuring—non-current	175	255
Capital lease obligations—non-current	50	—
Total liabilities	13,041	12,802
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; 37,015,094 and 31,195,681 shares issued and outstanding, respectively	37	31
Additional paid-in capital	233,793	203,623
Accumulated other comprehensive loss	23	(40)
Accumulated deficit	(159,202)	(161,192)
Total stockholders' equity	74,651	42,422
Total liabilities and stockholders' equity	$ 87,692	$ 55,224

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

AUTOBYTEL INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollar amounts in thousands, except share and per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Revenues:				
Program fees	$ 13,902	$ 15,441	$ 27,020	$ 30,853
Enterprise sales	3,479	2,743	6,834	4,727
Advertising	3,024	1,639	5,863	3,396
Other products and services	1,316	1,008	2,257	2,588
Total revenues	21,721	20,831	41,974	41,564
Operating expenses:				
Sales and marketing	13,109	13,236	25,967	25,496
Product and technology development	4,454	5,723	8,316	11,476
General and administrative	3,106	2,404	5,891	5,461
Autobytel.Europe restructuring and impairment charges	—	—	—	15,015
Domestic restructuring charges and other benefits, net	—	(58)	—	(58)
Total operating expenses	20,669	21,305	40,174	57,390
Income (loss) from operations	1,052	(474)	1,800	(15,826)
Loss on recapitalization of Autobytel.Europe	—	—	—	(4,168)
Interest income	61	113	130	504
Foreign currency exchange loss	—	(13)	—	(12)
Income (loss) in equity investees	14	(232)	67	(432)
Income (loss) before minority interest and income taxes	1,127	(606)	1,997	(19,934)
Minority interest	—	—	—	866
Income (loss) before income taxes	1,127	(606)	1,997	(19,068)
Provision for income taxes	5	1	7	6
Net income (loss)	$ 1,122	$ (607)	$ 1,990	$ (19,074)
Net income (loss) per share:				
Basic	$ 0.04	$ (0.02)	$ 0.06	$ (0.61)
Diluted	$ 0.03	$ (0.02)	$ 0.06	$ (0.61)
Shares used in computing net income (loss) per share:				
Basic	31,814,364	31,137,392	31,525,905	31,103,469
Diluted	33,950,507	31,137,392	33,138,530	31,103,469
Comprehensive income (loss):				
Net income (loss)	$ 1,122	$ (607)	$ 1,990	$ (19,074)
Translation adjustment	36	—	63	—
Comprehensive income (loss)	$ 1,158	$ (607)	$ 2,053	$ (19,074)

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

AUTOBYTEL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollar amounts in thousands, except share and per share data)

(unaudited)

	Six Months Ended June 30,	
	2003	**2002**
Cash flows from operating activities:		
Net income (loss)	$ 1,990	$(19,074)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Non-cash charges:		
Depreciation and amortization	1,228	1,849
Provision for bad debt	314	721
Loss on disposal of property and equipment	—	(11)
Stock-based compensation	51	20
Autobytel.Europe restructuring and impairment	—	15,015
Loss on recapitalization of Autobytel.Europe	—	4,168
(Income) loss in equity investees	(67)	432
Minority interest	—	(866)
Changes in assets and liabilities, net of acquired business:		
Accounts receivable	(995)	(2,156)
Prepaid expenses and other current assets	1,536	368
Other assets	23	58
Accounts payable	449	(4,397)
Accrued expenses	(1,022)	(3,765)
Accrued restructuring—current	(46)	(181)
Deferred revenues	66	(297)
Customer deposits	(76)	(6)
Other current liabilities	24	95
Accrued restructuring—non current	(80)	366
Net cash provided by (used in) operating activities	3,395	(7,661)
Cash flows from investing activities:		
Deconsolidation of Autobytel.Europe	—	(28,163)
Acquisition of business, net of cash acquired	(4,952)	—
Decrease in restricted cash	28	—
Investment in foreign entities	—	(400)
Purchases of property and equipment	(145)	(723)
Proceeds from sale of property and equipment	—	153
Capitalized software costs	—	(1,329)
Net cash used in investing activities	(5,069)	(30,462)
Cash flows from financing activities:		
Capital lease payments	(8)	—
Net proceeds from sale of common stock	25,809	218
Net cash provided by financing activities	25,801	218
Effect of exchange rates on cash	63	(488)
Net increase (decrease) in cash and cash equivalents	24,190	(38,393)
Cash and cash equivalents, beginning of period	27,543	61,837
Cash and cash equivalents, end of period	$51,733	$ 23,444
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	$ 7	$ 6
Cash paid during the period for interest	$ 2	$ —

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

Supplemental disclosure of non-cash investing and financing activities:

- In June 2003, in conjunction with the acquisition of AVV, Inc., assets of $20,200 were acquired, liabilities of $932 were assumed and 711,109 shares of common stock were issued. (See Note 4.)

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

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, advertising and customer relationship management (CRM) tools and programs primarily through the Internet. Autobytel owns and operates the automotive Web sites Autobytel.com, Autoweb.com, CarSmart.com and AutoSite.com, as well as AIC (Automotive Information Center), a provider of automotive marketing data and technology. Autobytel also owns and operates AVV, Inc. (AVV), a provider of dealership CRM and sales management tools and data extraction services.

Autobytel provides tools and programs to automotive dealers and manufacturers to help them increase marketing efficiency and reduce customer acquisition costs.

Autobytel is a Delaware corporation incorporated on May 17, 1996. Autobytel was previously formed in Delaware in January 1995 as a limited liability company under the name Auto-By-Tel LLC. 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.

Since its inception in January 1995, Autobytel has experienced annual operating losses and has an accumulated deficit of $159,202 as of June 30, 2003. Autobytel believes current cash and cash equivalents are sufficient to meet anticipated cash needs for working capital and capital expenditures for at least the next 12 months. Failure to generate sufficient revenues, raise additional capital or reduce discretionary spending could have a material adverse effect on Autobytel’s ability to achieve its intended business objectives.

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Statements

The accompanying interim consolidated financial statements as of June 30, 2003, and for the three months and six months ended June 30, 2003 and 2002, 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, 2002 included in Autobytel’s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 27, 2003.

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 a maturity of three months or less at the date of purchase to be cash equivalents. As of December 31, 2002, $28 was held by financial institutions as collateral for business credit cards.

Accounts Receivable, Net of Allowance for Doubtful Accounts and Customer Credits

Autobytel maintains allowances for doubtful accounts and customer credits. The allowance for doubtful accounts is an estimate of bad debt expense that could result from the inability or refusal of customers to pay for services. The estimated provision for doubtful accounts is charged to operating expenses. The allowance for customer credits is an estimate of adjustments for purchase requests or other services that do not meet our customers' quality expectations. The estimated provision for customer credits is recorded as a reduction in revenue. The estimates are based on Autobytel's historical bad debt expense and customer credit experience.

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 (loss) 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 (loss) by the weighted average shares of common stock outstanding during the period and common stock equivalents. Common stock equivalents, as determined under the treasury stock method, consist of common stock shares issuable upon exercise of stock options net of common stock shares assumed to be repurchased by the company from the exercise proceeds. Common stock equivalents are excluded from the computation if their effect is antidilutive.

For the three months and six months ended June 30, 2003, there were 2,136,143 and 1,612,625 common stock equivalents, respectively, and for the three months and six months ended June 30, 2002, there were 929,451 and 839,487 common stock equivalents, respectively. Common stock equivalents were excluded from the calculation of diluted net loss per share for the three months and six months ended June 30, 2002 as they were antidilutive.

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 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 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. Had the provisions of SFAS No. 123 been applied to Autobytel's stock option grants for its stock-based compensation plans, Autobytel's net loss and net loss per share for the three months and six months ended June 30, 2003 and 2002 would approximate the pro forma amounts below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Net income (loss):				
As reported	$ 1,122	$ (607)	$ 1,990	$(19,074)
Stock based compensation, net of tax	(1,110)	(901)	(2,347)	(2,438)
Pro forma	$ 12	$(1,508)	$ (357)	$(21,512)
Net income (loss) per share—basic:				
As reported	$ 0.04	$ (0.02)	$ 0.06	$ (0.61)
Pro forma	$ —	$ (0.05)	$ (0.01)	$ (0.69)
Net income (loss) per share—diluted:				
As reported	$ 0.03	$ (0.02)	$ 0.06	$ (0.61)
Pro forma	$ —	$ (0.05)	$ (0.01)	$ (0.68)

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

In the six months ended June 30, 2003, Autobytel granted 1,264,000 stock options to employees and directors. The options granted were estimated to have a fair value of $2,917 based on 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.

As of June 30, 2003, Autobytel had a total of 6,182,820 stock options outstanding, of which 4,929,546 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 primarily through the Internet.

New Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. Autobytel adopted SFAS No. 143 on January 1, 2003. The adoption did not have a material effect on Autobytel's financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. Autobytel adopted SFAS No. 146 on January 1, 2003. The adoption did not have a material effect on Autobytel's financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. (FIN) 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others." FIN 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002; while the provisions of the disclosure requirements are effective for financial statements of interim or annual reports ending after December 15, 2002. Autobytel adopted the disclosure requirements on December 31, 2002 and the recognition and measurement provisions on January 1, 2003. The adoption of FIN 45 did not have a material effect on Autobytel's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" which amends SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires prominent disclosure about the method of accounting and the effect of the method used on reported results in both annual and interim financial statements. SFAS No. 148 is effective for fiscal years ending after December 15, 2002 and interim periods beginning after December 15, 2002. Autobytel adopted SFAS No. 148 on January 1, 2003 and has elected to continue to account for its stock-based compensation in accordance with the provisions of APB No. 25.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities," an Interpretation of Accounting Research Bulletin No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. Autobytel does not expect the adoption of FIN 46 to have a material effect on its financial position or results of operations.

3. Autobytel.Europe LLC

Autobytel.Europe's results of operations were consolidated in Autobytel's results of operations through March 28, 2002. 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 no longer consolidates Autobytel.Europe in its financial statements but accounts for its remaining investment in Autobytel.Europe under the equity method. As of June 30, 2003, Autobytel had an investment in Autobytel.Europe with a balance of $4,812.

4. Acquisition of Applied Virtual Vision, Inc.

On June 4, 2003, Autobytel acquired Applied Virtual Vision, Inc., now AVV, Inc., a provider of CRM and sales management tools and data extraction services, in exchange for cash and common stock. The acquisition has been accounted for using the purchase method of accounting.

The aggregate purchase price was $9,414 and consisted of $4,800 in cash, common stock valued at $4,316 and transaction costs of $298. The value of the stock issued was determined based on the average market price of Autobytel's common stock for the 2 days before through the 2 days after the date the acquisition agreement was consummated. The purchase price has been allocated to the assets acquired and liabilities assumed on the basis of their respective estimated fair values on the acquisition date as follows:

Purchase price:	
Cash	$4,800
Common stock (711,109 shares at $6.07 per share)	4,316
Transaction costs paid by Autobytel	298
Total purchase price	$9,414
Allocation of purchase price:	
Assets:	
Cash	$ 146
Other current assets	838
Non-current assets	470
Goodwill	8,472
Intangibles	420
Liabilities:	
Current liabilities	(873)
Non-current liabilities	(59)
Total purchase price	$9,414

The excess of the purchase price over the estimated fair value of the assets acquired and the liabilities assumed was recorded as goodwill in the amount of $8,472. The amount of goodwill is subject to adjustment as additional information regarding the fair value of the assets acquired and liabilities assumed becomes available. Goodwill is not deductible for tax purposes. In accordance with SFAS No. 142, goodwill acquired in the AVV acquisition is not amortized, rather it is evaluated on at least an annual basis for impairment. Intangible assets acquired consist of developed technology and customer relationships and are amortized over an estimated useful life of three years or less.

AVV's financial position and results of operations from the date of acquisition on June 4, 2003 through June 30, 2003 have been included in the accompanying consolidated financial statements.

The following summarized unaudited pro forma consolidated results of operations are presented as if the acquisition of AVV, Inc. had occurred on January 1, 2002. The unaudited pro forma results are not necessarily indicative of future earnings or earnings that would have been reported had the acquisition been completed as presented.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Revenue	$23,127	$21,969	$44,366	$ 43,732
Net income (loss)	$ 775	$ (450)	$ 1,729	$(18,827)
Net income (loss) per share:				
Basic and diluted	$ 0.02	$ (0.01)	$ 0.05	$ (0.59)

5. Acquired Intangible Assets

Intangible assets recorded as a part of the AVV acquisition are amortized over an estimated life of three years or less and consist of the following:

	As of June 30, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Amount
Developed technology	$ 220	$ (6)	$ 214
Customer relationships	200	(9)	191
Total	$ 420	$ (15)	$ 405

Amortization expense for the three months and six months ended June 30, 2003 was $15. Amortization expense for each of the next five years is estimated to be as follows:

	Amortization Expense
Six months ended December 31, 2003	$ 90
2004	$ 153
2005	$ 113
2006	$ 47
2007	$ —

6. Commitments and Contingencies

Litigation

On October 10, 2002, Morrison & Foerster LLP, a law firm that represented Autobytel, A.I.N., Inc. and Michael Gorun, former President of A.I.N., at various points in litigation which was settled in 2002, filed an action entitled Morrison & Foerster LLP v. Autobytel.com Inc. et al. in the Santa Clara Superior Court against Autobytel, A.I.N. and Mr. Gorun asserting claims for damages for beach of contract for failure to pay legal fees and expenses plus interest accrued thereon in the aggregate amount of approximately $660. On July 15, 2003, Autobytel, A.I.N. and Morrison & Foerster LLP settled the matter described above. The settlement amount was accrued as of June 30, 2003.

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. Autobytel has approved a Memorandum of Understanding ("MOU") and related agreements which set forth the terms of a settlement between Autobytel and the plaintiff class. It is anticipated that any potential financial obligation of Autobytel to plaintiffs due pursuant to the terms of the MOU and related agreements will be covered by existing insurance. Therefore, Autobytel does not expect that the settlement will involve payment by Autobytel. The MOU and related agreements are subject to a number of contingencies, including the approval of the MOU by a sufficient number of the other approximately 300 companies who are part of the consolidated case, the negotiation of a settlement agreement, and approval by the court. Autobytel cannot determine whether or when a settlement will occur or be finalized and whether the outcome of the litigation will have a material impact on its results of operations or financial condition 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. Autoweb has approved the MOU and related agreements which set forth the terms of a settlement between Autoweb and the plaintiff class. It is anticipated that any potential financial obligation of Autoweb to plaintiffs due pursuant to the terms of the MOU and related agreements will be covered by existing insurance. Therefore, Autoweb does not expect that the settlement will involve payment by Autoweb. The MOU and related agreements are subject to a number of contingencies, including the approval of the MOU by a sufficient number of the other approximately 300 companies who are part of the consolidated case, the negotiation of a settlement agreement, and approval by the court. Autobytel cannot determine whether or when a settlement will occur or be finalized and whether the outcome of the litigation will have a material impact on its results of operations or financial condition in any future period.

On February 28, 2003, a purported class action lawsuit was filed in the United States District Court for the Southern District of Florida. The complaint named Autoweb, the former Chief Executive Officer and the former Chief Financial Officer of Autoweb, and CSFB, the co-lead underwriter of Autoweb's initial public offering, as defendants. The complaint alleged claims against Autoweb and such former officers for violations of the Securities Act of 1933, Securities Exchange Act of 1934, and Florida's Blue Sky laws and also alleged claims based on common law theories of fraud, negligent misrepresentation and respondeat superior. The complaint made similar allegations against approximately 50 other companies for which CSFB was the lead or a co-lead underwriter. The complaint alleged that the defendants disseminated false and misleading information to the public which misrepresented the accuracy of Autoweb's initial public offering price, its financial condition and future revenue prospects. The complaint further alleged that the effect of the purported fraud was to manipulate Autoweb's stock price so that the defendants could profit from the manipulation. The action sought damages in an unspecified amount. On June 19, 2003, an amended complaint was filed in this action. The amended complaint states that plaintiffs have voluntarily dismissed Autoweb as a defendant without prejudice.

Autobytel has reviewed the above class action matters in accordance with SFAS No. 5, "Accounting for Contingencies," and has determined that a reserve for loss contingencies is not required at this time.

7. Private Placement of Equity

On June 24, 2003, Autobytel completed the sale of 5,000,000 shares of common stock to six institutional investor groups in a private placement for gross proceeds of $27,000, or $5.40 per share. Net proceeds after transaction costs were $25,580. Autobytel intends to use the proceeds for general corporate purposes, including potential acquisitions.

8. Accrued Liability for Restructuring and Other Charges

In 2001, Autobytel recorded a total of $4,514 for domestic restructuring and other charges. The charges were related to the reorganization of dealer operations, the elimination of duplicate facilities, the write-down of fixed assets, contract termination costs related to online advertising and the aftermarket program on the Autobytel.com Web site, the write-off of previously capitalized software related to the aftermarket program and the integration of Autoweb into Autobytel following the acquisition of Autoweb. 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 AIC's office facilities.

As of June 30, 2003, there were no further accrued liabilities related to the 2001 restructuring and other charges as the remaining charges were adjusted due to the final reconciliation of leased facility maintenance costs by the landlord. The accrued liabilities related to the 2001 charges as of June 30, 2003 were paid or adjusted as follows:

	Domestic Restructuring and Other Charges
Total charges	$ 4,514
Non-cash charges	(739)
Cash payments	(3,665)
December 31, 2001, accrued liability balance	110
Cash payments	(76)
December 31, 2002, accrued liability balance	34
Cash payments	(7)
March 31, 2003, accrued liability balance	27
Non-cash adjustment	(27)
June 30, 2003, accrued liability balance	$ —

As of June 30, 2003, the remaining accrued liabilities related to the 2002 restructuring charges were $352. Autobytel expects the remaining charges to be paid by 2005. The remaining accrued liabilities related to the 2002 charges as of June 30, 2003 were as follows:

	Domestic Restructuring Charges		
	Rent	Compensation	Total
Total charges	$ 552	$ 217	$ 769
Cash payments	(108)	(217)	(325)
December 31, 2002, accrued liability balance	444	—	444
Cash payments	(61)	—	(61)
March 31, 2003, accrued liability balance	383	—	383
Cash payments	(31)	—	(31)
June 30, 2003 accrued liability balance	$ 352	$ —	$ 352

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, advertising and customer relationship management (CRM) tools and programs primarily through the Internet. We own and operate the automotive Web sites Autobytel.com, Autoweb.com, CarSmart.com and AutoSite.com, as well as AIC (Automotive Information Center), a provider of automotive marketing data and technology. We also own and operate AVV, Inc. (AVV), a provider of dealership CRM and sales management tools and data extraction services.

On June 4, 2003, we acquired Applied Virtual Vision, Inc., now AVV, Inc. We acquired AVV for 711,109 shares of our common stock and $4.8 million in cash. We have included AVV's financial position and results of operations, including revenues, expenses, cash flows and other relevant operating activity, from the date of acquisition in the discussion and analysis of our consolidated financial position and results of operations below.

On June 24, 2003, we completed the sale of a total of 5,000,000 shares of common stock to six institutional investor groups in a private placement for gross proceeds of $27.0 million, or $5.40 per share. Net proceeds after commissions and other transaction costs were $25.6 million. We intend to use the proceeds for general corporate purposes, including potential acquisitions.

In the second quarter of 2003, we generated $2.3 million in cash from operations primarily due to increased sales to major dealer groups and manufacturers, increased advertising revenues, reduced expenses and continued focus on aggressive collection efforts. In addition, we received net proceeds of $25.6 million from the private placement of equity and paid a total of $5.0 million in purchase price and transaction costs for the acquisition of AVV. Although there is no assurance, we expect to continue to generate cash from operations in 2003.

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

Program fees consist of fees paid by program dealers who participate in our Autobytel.com, Autoweb.com and CarSmart.com online car buying referral networks. Program fees also consist of fees paid by dealers who use our lead management tools. Fees paid by program dealers participating in our car buying referral networks are comprised of monthly subscription and transaction fees for qualified consumer leads, or purchase requests, which are directed to participating program dealers. Autobytel.com program dealers using our referral services pay ongoing monthly subscription fees based, among other things, on the size of territory, demographics and, indirectly, the transmittal of qualified purchase requests to them. Autoweb.com and CarSmart.com program dealers using our referral services pay ongoing monthly subscription fees or transaction fees based on the number of qualified purchase requests provided to them each month. Program dealers using our lead management tools pay ongoing monthly subscription fees based on the level of functionality they have selected from our suite of lead management tools. Program fees include revenues from AVV beginning on the date of acquisition, June 4, 2003. We expect to be primarily dependent on our program dealers for revenues in the foreseeable future.

Our program dealer contract terms generally range from 90 days to one year and are terminable on 30 days' notice by either party, except that AVV contracts are terminable only by AVV for breach. In the first quarter of 2003 we began an effort to sign new dealers to contracts with an initial term in excess of 30 days that are terminable on 30 days' notice by us and automatically renew unless either party elects not to renew. The majority of our program fees consist of monthly fees which are recognized in the period service is provided. For the three months ended June 30, 2003 and 2002, program fees were $13.9 million and $15.4 million, or 64% and 74% of total revenues, respectively. Average monthly program fees per dealer were $892 and $846 in the second quarter of 2003 and 2002, respectively.

Enterprise sales include fees from major dealer groups and automotive manufacturers for purchase requests delivered to enterprise dealers and for use of our lead management tools and services as well as fees from manufacturers and other users for automotive marketing data and technology. Enterprise dealers consist of (i) dealers that are part of major dealer groups with more than 25 dealerships with which we have a single agreement and (ii) dealers that are eligible to receive purchase requests from us and/or use our lead management tools and services 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, Mercedes Benz and Mazda. We intend to strengthen the size and quality of our relationships with major dealer groups, automotive manufacturers and other users of automotive marketing services and technology. Enterprise sales include revenues from AVV beginning on the date of acquisition, June 4, 2003. Revenues from enterprise sales were $3.5 million and $2.7 million, or 16% and 13% of total revenues, in the second quarter of 2003 and 2002, respectively.

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. Using the targeted nature of Internet advertising, manufacturers can advertise their brands effectively on any of our four Web sites by targeting advertisements to consumers who are researching vehicles, thereby increasing the likelihood of influencing their purchase decisions. In particular, our Dynamic Content Placement (DCP) product allows manufacturers to automatically present specific comparative information relevant to the vehicle that is being researched to car shoppers using our Web sites. Supported by data and technology provided by AIC, DCP targets consumers deep into the research and decision-making process as they compare various vehicles online. In addition, our customizable advertising product, the Featured Model Showcase, offers manufacturers the opportunity to present detailed, enhanced information about a specific vehicle model to millions of online car shoppers on our Web sites. Features can include purchase request functionality, image galleries, brochure requests and video. With the investment in our advertising sales organization and further selling of our advertising inventory, we anticipate that our advertising business in 2003 will increase compared to 2002. Revenues from advertising were $3.0 million and $1.6 million in the second quarter of 2003 and 2002, or 14% and 8% of total revenues, respectively.

Revenues from other products and services include fees from our customer loyalty and retention marketing program for dealerships and manufacturers called RPM, international licensing agreements and other products and services. Beginning on June 4, 2003, the acquisition date of AVV, revenues from other products and services also include fees from our data extraction service. We expect to increase the number of dealers subscribing to our RPM program. In the second quarter of 2003 and 2002, revenues from other products and services were $1.3 million and $1.0 million, or 6% and 5% of total revenues, respectively.

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 strong purchase intent before delivering the purchase request to our program and enterprise dealers. During the second quarter we also implemented custom filters and validation processes to enable dealers to further enhance our existing process of validating consumer information. As a result of the implementation of QVS and other quality enhancing processes, purchase request quality has increased. 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 anticipate that improved purchase request quality will help us increase closing ratios and further reduce customer credits, reduce dealer turnover and increase revenues in the future.

We delivered approximately 791,000 and 996,000 purchase requests through our online systems to program and enterprise dealers in the second quarter of 2003 and 2002, respectively. Of these, approximately 579,000 and 851,000 were delivered to program dealers and approximately 212,000 and 145,000 were delivered to enterprise dealers in the second quarter of 2003 and 2002, respectively. Purchase requests delivered to program dealers in the second quarter of 2003 decreased by 272,000, or 32%, compared to the second quarter of 2002. The decrease was primarily a result of QVS as we rejected purchase requests that did not meet our qualification standards and a decline in our number of program dealer relationships due, in part, to our efforts to retain dealers that provide a reasonable profit to us. Our revenue per purchase request from program dealers was $23.48 and $17.92 in the second quarter of 2003 and 2002, respectively. We expect to deliver over 800,000 purchase requests to program dealers and enterprise dealers in each of the remaining quarters of 2003.

We had over 21,000 and 20,000 dealer relationships, excluding AVV, as of June 30, 2003 and March 31, 2003, respectively. Our dealer relationships consisted of approximately 15,900 enterprise dealer relationships, 4,900 program dealer relationships and 300 RPM dealer relationships as of June 30, 2003. As of March 31, 2003, our dealer relationships consisted of approximately 14,700 enterprise dealer relationships, 5,100 program dealer relationships and 200 RPM dealer relationships. A program with a major manufacturer increased enterprise dealer relationships by approximately 11,500 in the third quarter of 2002. The program automatically extends in one month increments until terminated by us or the manufacturer.

AVV’s methodology of counting dealers is different than Autobytel’s methodology of counting dealer relationships. We estimate that we had over 3,000 AVV dealers as of June 30, 2003. However, the actual number of AVV dealers may be higher or lower than the estimate.

To enhance our subscribing dealers' ability to sell cars using our programs, we developed and implemented various tools and processes to improve our dealer support. We contact all dealers new to our programs to confirm their initiation on our programs and train their personnel on the use of our programs and tools. We also contact our dealers on a regular basis to identify dealers who are not using our programs effectively, develop relationships with dealer principals and their personnel responsible for calling our customers and to inform our dealers about their effectiveness using surveys completed by our purchase-intending customers. We are realigning and investing additional resources in our sales and support departments to improve our dealer relationships.

Our relationship with 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
- selling or termination of the dealer franchise.

We cannot assure that we will be able to reduce our dealer turnover. Our inability or failure to reduce dealer turnover could have a material adverse effect on our business, results of operations and financial condition.

Because our primary revenue source is from program fees, our business model is significantly 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 significant cost of goods sold, no procurement, carrying or shipping costs and no inventory risk.

Sales and marketing costs consist primarily of:

- fees paid to our Internet purchase request providers, including Internet portals and online automotive information providers,
- promotion and advertising expenses to build our brand awareness and encourage potential customers to visit our Web sites and
- personnel and other costs associated with sales, marketing, training and support of our dealer networks.

Our Internet marketing and advertising costs, including annual, monthly and variable fees, were $7.7 million and $8.2 million in the second quarter of 2003 and 2002, respectively. Also included in sales and marketing expenses are the costs related to signing up new dealers and their ongoing training and support, costs to support our advertising and RPM revenues and costs associated with traditional media, such as television, radio and print advertising. Sales and marketing costs are recorded as an expense in the period the service is provided. We expect sales and marketing expenses as a percentage of revenue to slightly increase in 2003 compared to 2002.

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Revenues				
Program fees	64%	74%	64%	74%
Enterprise sales	16	13	16	11
Advertising	14	8	14	8
Other products and services	6	5	6	7
Total revenues	100	100	100	100
Operating expenses:				
Sales and marketing	60	64	62	61
Product and technology development	21	27	20	28
General and administrative	14	12	14	13
Autobytel.Europe restructuring and impairment charges	—	—	—	36
Domestic restructuring and other charges (benefits)	—	—	—	—
Total operating expenses	95	103	96	138
Income (loss) from operations	5	(3)	4	(38)
Loss on recapitalization of Autobytel.Europe	—	—	—	(10)
Other income	—	—	1	—
Income (loss) before minority interest and income taxes	5	(3)	5	(48)
Minority interest	—	—	—	2
Income (loss) before income taxes	5	(3)	5	(46)
Provision for income taxes	—	—	—	—
Net income (loss)	5%	(3)%	5%	(46)%

Three Months Ended June 30, 2003 and 2002

Revenues. Our revenues increased by $0.9 million, or 4%, to $21.7 million in the second quarter of 2003 compared to $20.8 million in the second quarter of 2002.

Program Fees. Program fees consist of fees paid by program dealers who participate in our new and used online car buying referral networks. Program fees also consist of fees paid by dealers who use our lead management tools. Fees paid by program dealers participating in our referral networks are comprised of monthly subscription and transaction fees for qualified consumer leads, or purchase requests, which are directed to participating program dealers. Dealers using our referral services pay transaction fees based on the number of qualified purchase requests provided to them each month, or ongoing monthly subscription fees based, among other things, on the size of territory, demographics and, indirectly, the transmittal of qualified purchase requests to them. Program dealers using our lead management tools pay ongoing monthly subscription fees based on the level of functionality selected from our suite of lead management tools. Program fees include revenues from AVV beginning on the date of acquisition, June 4, 2003. Program fees decreased by $1.5 million, or 10%, to $13.9 million in the second quarter of 2003 compared to $15.4 million in the second quarter of 2002. The decrease was primarily due to a decline in the number of paying dealers participating in our referral networks and the quantity of purchase requests delivered to them partially offset by an increase in average monthly program fees per dealer and revenue per purchase request. The number of paying program dealers participating in our referral networks was 5,008 and 5,971 as of June 30, 2003 and 2002, respectively. The number of purchase requests delivered to them was 579,000 and 851,000, average monthly program fees per dealer were $892 and $846 and revenue per purchase request was $23.48 and $17.92 in the second quarter of 2003 and 2002, respectively. The decrease in program fees was also partially offset by $0.3 million in fees from dealers using our lead management tools as a result of the AVV acquisition. We intend to continue our efforts to send dealers only qualified purchase requests, improve dealer support, increase our fees per purchase request and increase our revenues from dealers using our lead management tools. However, we expect our program fee revenues to slightly decline in 2003 compared to 2002 as we work to improve our dealer retention.

Enterprise Sales. Enterprise sales include fees from major dealer groups and automotive manufacturers for purchase requests delivered to enterprise dealers and for use of our lead management tools and services as well as fees from manufacturers and other users for automotive marketing data and technology. Enterprise dealers consist of (i) dealers that are part of major dealer groups with more than 25 dealerships with which we have a single agreement and (ii) dealers that are eligible to receive purchase requests from us and/or use our lead management tools and services 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 General Motors, Ford, Mercedes Benz and Mazda. Enterprise sales increased by $0.8 million, or 27%, to $3.5 million in the second quarter of 2003 compared to $2.7 million in the second quarter of 2002. The increase was primarily due to selling more purchase requests to existing customers, improving the quality of our purchase requests and adding new enterprise customers. The acquisition of AVV contributed $0.1 million to enterprise sales in the second quarter of 2003. The number of purchase requests delivered to enterprise dealers was 212,000 and 145,000 in the second quarter of 2003 and 2002, respectively. We may add new enterprise customers and, therefore, revenues from enterprise sales may increase in 2003 compared to 2002.

Advertising. Revenues from advertising represent fees received from automotive manufacturers and other advertisers who target car buyers during the research, consideration and decision making process on our Web sites. Advertising revenue increased by $1.4 million, or 85%, to $3.0 million in the second quarter of 2003 compared to $1.6 million in the second quarter of 2002. The increase was primarily due to higher spending by automotive manufacturers, more effectively selling our advertising inventory and an increase in the pricing of our advertising and number of automotive manufacturer customers. With the investment in our advertising sales organization, further selling of our available advertising inventory, an increase in Internet advertising spending and the introduction of our Dynamic Content Placement and Featured Model Showcase products, we expect our advertising revenues to increase in 2003 compared to 2002.

Other Products and Services. Revenues from other products and services include fees from RPM, international licensing agreements and other products and services. Also, with the acquisition of AVV on June 4, 2003, revenues from other products and services include fees from our data extraction service. Revenues from other products and services increased by $0.3 million, or 31%, to $1.3 million in the second quarter of 2003 compared to $1.0 million in the second quarter of 2002. The increase was primarily due to a $0.8 million increase in RPM revenues and $0.1 million as a result of the AVV acquisition, partially offset by a $0.6 million decrease in other products and services, such as international licensing, database marketing, financing and classified listings. We continue to focus our efforts on offering marketing services to dealers and automotive manufacturers. We expect increases in revenues from RPM in 2003 compared to 2002.

Sales and Marketing. Sales and marketing expense primarily includes advertising and marketing expenses paid to our purchase request providers and for developing our brand equity, as well as personnel and other costs associated with dealer sales, RPM and AVV sales, web site advertising sales, and dealer training and support. Sales and marketing expense decreased by $0.1 million, or 1%, to $13.1 million in the second quarter of 2003 compared to $13.2 million in the second quarter of 2002. This represents 60% and 64% as a percent of total revenues for the second quarter of 2003 and 2002, respectively. The decrease was primarily due to a $0.5 million decrease in online advertising as a result of the cost saving efficiencies of QVS partially offset by a $ 0.2 million increase in traditional advertising expenses and a $0.2 million increase in costs associated with sales and customer relationship maintenance. We expect our sales and marketing expenses as a percentage of revenues to slightly increase in 2003 compared to 2002.

Product and Technology Development. Product and technology development expense primarily includes personnel costs related to developing new products, enhancing the features, content and functionality of our Web sites, our Internet-based communications platform, costs associated with our telecommunications and computer infrastructure, costs related to data and technology development and amortization of software development costs. Product and technology development expense decreased by $1.2 million, or 22%, to $4.5 million in the second quarter of 2003 compared to $5.7 million in the second quarter of 2002. This represents 21% and 27% of total revenues for the second quarter of 2003 and 2002, respectively. The decrease was primarily due to a $0.5 million decrease in personnel and related costs, a $0.3 million decrease in consulting fees due to more effective use of internal resources, a $0.2 million decrease in amortization of software development costs and a $0.2 million decrease in telecommunications and co-location facilities costs as a result of renegotiated vendor agreements. In the second quarter of 2003, we did not capitalize software development costs. In the second quarter of 2002, we capitalized $0.4 million of software development costs related to enhancements to RPM. We expect our product and technology development expenses as a percentage of revenues to decrease in 2003 compared to 2002.

General and Administrative. General and administrative expense primarily consists of executive, financial and legal personnel expenses and costs related to being a public company. General and administrative expense increased by $0.7 million, or 29%, to $3.1 million in the second quarter of 2003 compared to $2.4 million in the second quarter of 2002. This represents 14% and 12% of total revenues for the second quarter of 2003 and 2002, respectively. The increase was primarily due to $0.4 million related to the relocation of our AIC operations from Westborough, Massachusetts to our corporate office in Irvine, California, and a $0.3 million increase in legal and public company expenses. We expect our general and administrative expenses as a percentage of revenues to slightly increase in 2003 compared to 2002 due to higher insurance costs and fees associated with regulatory requirements for public companies.

Domestic restructuring and other charges . In the second quarter of 2002, we recorded a net benefit of $0.1 million in domestic restructuring and other charges. The net benefit consisted of a $1.0 million benefit related to a reduction in the original estimate of a negotiated settlement with a vendor, discounted legal fees and recovered legal costs from an insurance company, partially offset by charges of $0.9 million related to our lease obligation on the vacant portion of AIC's office facilities, severance costs for the restructuring of our operations to reduce costs and enhance efficiencies and abandoned acquisition costs.

Income (Loss) in Equity Investees. Income (loss) in equity investees represents our share of income or loss in our Autobytel.Europe and Australian venture. In the second quarter of 2002, the loss recognized for Autobytel Australia was $0.2 million. Autobytel Australia ceased operations in August 2002.

Income Taxes. No provision for federal income taxes has been recorded as we generated taxable losses through December 31, 2002 and we expect nominal taxable income for the year ending December 31, 2003. As of December 31, 2002, we had approximately $127.7 million of federal and $77.4 million of state net operating loss carryforwards available to offset future taxable income. Of the $127.7 million of federal and $77.4 million of state net operating loss carryforwards, $16.6 million and $16.6 million, respectively, relate to Autoweb activities prior to the acquisition. These net operating loss carryforwards expire in various years through 2022. Also, Autobytel has federal and state research tax credit carryforwards of $0.2 million and $0.2 million, respectively. Utilization of the net operating losses are 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 net operating loss carryforwards before utilization. Additionally, the state of California has suspended the deduction for net operating loss carryovers for the tax years 2002 and 2003.

Six Months Ended June 30, 2003 and 2002

Revenues. Our revenues increased by $0.4 million, or 1%, to $42.0 million in the six months ended June 30, 2003 compared to $41.6 million in the same period of 2002.

Program Fees. Program fees decreased by $3.9 million, or 12%, to $27.0 million in the six months ended June 30, 2003 compared to $30.9 million in the same period of 2002. The decrease was primarily due to a decline in the number of paying dealers participating in our referral networks and the quantity of purchase requests delivered to them partially offset by an increase in average monthly program fees per dealer and revenue per purchase request. The number of paying program dealers was 5,008 and 5,971 as of June 30, 2003 and 2002, respectively. The number of purchase requests delivered to them was 1.2 million and 1.8 million, average monthly program fees per dealer were $860 and $807 and revenue per purchase request was $22.32 and $17.01 for the six months ended June 30, 2003 and 2002, respectively. The decrease in program fees was also partially offset by $0.3 million in fees from dealers using our lead management tools as a result of the AVV acquisition. We intend to continue our efforts to send dealers only qualified purchase requests, improve dealer support, increase our fees per purchase request and increase our revenues from dealers using our lead management tools. However, we expect our program fee revenues to slightly decline in 2003 compared to 2002 as we work to improve our dealer retention.

Enterprise Sales. Enterprise sales increased by $2.1 million, or 45%, to $6.8 million in the six months ended June 30, 2003 compared to $4.7 million in the same period of 2002. The increase was primarily due to selling more purchase requests to existing customers, improving the quality of our purchase requests and adding new enterprise customers. The acquisition of AVV contributed $0.1 million to enterprise sales in the second quarter of 2003. The number of purchase requests delivered to enterprise dealers was 395,000 and 221,000 in the six months ended June 30, 2003 and 2002, respectively. We may add new enterprise customers and, therefore, revenues from enterprise sales may increase in 2003 compared to 2002.

Advertising. Advertising revenue increased by $2.5 million, or 73%, to $5.9 million in the six months ended June 30, 2003 compared to $3.4 million in the same period of 2002. The increase was primarily due to higher spending by automotive manufacturers, more effectively selling our advertising inventory and an increase in the pricing of our advertising and number of automotive manufacturer customers. With the investment in our advertising sales organization, further selling of our available advertising inventory, an increase in Internet advertising spending and the introduction of our Dynamic Content Placement and Featured Model Showcase products, we expect our advertising revenues to increase in 2003 compared to 2002.

Other Products and Services. Revenues from other products and services decreased by $0.3 million, or 13%, to $2.3 million in the six months ended June 30, 2003 compared to $2.6 million in the same period of 2002. The decrease was primarily due to a $1.9 million decrease in revenues from international licensing and other products and services, such as database marketing, financing and classified listings, partially offset by a $1.5 million increase in RPM revenues and $0.1 million as a result of the AVV acquisition. We continue to focus our efforts on offering marketing services to dealers and automotive manufacturers. We expect increases in revenues from RPM in 2003 compared to 2002.

Sales and Marketing. Sales and marketing expense increased by $0.5 million, or 2%, to $26.0 million in the six months ended June 30, 2003 compared to $25.5 million in the same period of 2002. This represents 62% and 61% as a percent of total revenues for the six months ended June 30, of 2003 and 2002, respectively. The increase was primarily due to a $1.0 million increase in costs associated with sales and customer relationship maintenance, a $0.2 million increase in marketing personnel and related costs, a $0.2 million increase in other marketing and advertising expenses and a $0.1 million increase in traditional advertising expenses partially offset by a $1.0 million decrease in online advertising as a result of the cost saving efficiencies of QVS. We expect our sales and marketing expenses as a percentage of revenues to slightly increase in 2003 compared to 2002.

Product and Technology Development. Product and technology development expense decreased by $3.2 million, or 28%, to $8.3 million in the six months ended June 30, 2003 compared to $11.5 million in the same period of 2002. This represents 20% and 28% of total revenues for the six months ended June 30, 2003 and 2002, respectively. The decrease was primarily due to a $1.5 million decrease in personnel and related costs, a $0.7 million decrease in professional consulting fees due to more effective use of internal resources, a $0.5 million decrease in amortization of software development costs, a $0.3 million decrease in telecommunications and co-location facilities costs as a result of renegotiated vendor agreements and a $0.2 million decrease in other product and technology development expenses. In the six months ended June 30, 2003, we did not capitalize software development costs. In the six months ended June 30, 2002, we capitalized $1.3 million of software development costs related to enhancements to RPM. We expect our product and technology development expenses as a percentage of revenues to decrease in 2003 compared to 2002.

General and Administrative. General and administrative expense increased by $0.4 million, or 8%, to $5.9 million in the six months ended June 30, 2003 compared to $5.5 million in the same period of 2002. This represents 14% and 13% of total revenues for the six months ended June 30, 2003 and 2002, respectively. The increase was primarily due to $0.4 million related to the relocation of our AIC operations from Westborough, Massachusetts to our corporate office in Irvine, California. We expect our general and administrative expenses as a percentage of revenues to slightly increase in 2003 compared to 2002 due to higher insurance costs and fees associated with regulatory requirements for public companies.

Autobytel.Europe Restructuring and Impairment Charges. In the six months ended June 30, 2002, we recorded non-cash charges of $4.0 million for terminated Autobytel.Europe contracts and $11.0 million for the impairment of our investment in Autobytel.Europe.

Domestic restructuring and other charges . In the six months ended June 30, 2002, we recorded a net benefit of $0.1 million in domestic restructuring and other charges. The net benefit consisted of a $1.0 million benefit related to a reduction in the original estimate of a negotiated settlement with a vendor, discounted legal fees and recovered legal costs from an insurance company, partially offset by charges of $0.9 million related to our lease obligation on the vacant portion of AIC's office facilities, severance costs for the restructuring of our operations to reduce costs and enhance efficiencies and abandoned acquisition costs.

Loss on Recapitalization of Autobytel.Europe. In the six months ended June 30, 2002, we recorded a non-cash charge of $4.2 million related to the partial disposition of our investment in Autobytel.Europe.

Interest Income. In the six months ended June 30, 2003, interest income decreased by $0.4 million, or 74%, to $0.1 million compared to $0.5 million in the same period of 2002 due to lower average cash balances and declining interest rates.

Income (Loss) in Equity Investees. In the six months ended June 30, 2003, we recognized $0.1 million as our share of income in Autobytel.Europe. In the six months ended June 30, 2002, the loss recognized for Autobytel Australia was $0.4 million. Autobytel Australia ceased operations in August 2002.

Minority Interest. Minority interest represents the portion of Autobytel.Europe's net loss allocable to other Autobytel.Europe shareholders. A portion of the loss generated by Autobytel.Europe, our majority-owned subsidiary through March 28, 2002, was allocated to its other shareholders resulting in a gain of $0.9 million in the six months ended June 30, 2002. As of March 29, 2002, Autobytel.Europe was no longer a majority-owned subsidiary as we reduced our ownership to 49%.

Income Taxes. No provision for federal income taxes has been recorded as we generated taxable losses through December 31, 2002 and we expect nominal taxable income for the year ending December 31, 2003. As of December 31, 2002, we had approximately $127.7 million of federal and $77.4 million of state net operating loss carryforwards available to offset future taxable income. Of the $127.7 million of federal and $77.4 million of state net operating loss carryforwards, $16.6 million and $16.6 million, respectively, relate to Autoweb activities prior to the acquisition. These net operating loss carryforwards expire in various years through 2022. Also, Autobytel has federal and state research tax credit carryforwards of $0.2 million and $0.2 million, respectively. Utilization of the net operating losses are 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 net operating loss carryforwards before utilization. Additionally, the state of California has suspended the deduction for net operating loss carryovers for the tax years 2002 and 2003.

Stock Options Granted in 2003

From January 1, 2003 through June 30, 2003, we granted stock options to purchase 1,264,000 shares of common stock under our 1999 Employee and Acquisition Related Stock Option Plan and 2000 Stock Option Plan. The stock options were granted at the closing price on the date of grant. As of June 30, 2003, we had 6,182,820 outstanding stock options.

Employees

As of July 31, 2003, we had a total of 321 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

We had $51.7 million in cash and cash equivalents as of June 30, 2003. Our cash balance increased by $24.2 million in the first six months of 2003 compared to a decrease of $38.4 in the first six months of 2002.

Net cash provided by operating activities was $3.4 million for the six months ended June 30, 2003 compared to net cash used of $7.7 million in the same period of 2002. Net cash provided for the six months ended June 30, 2003 resulted from net income for the period before non-cash charges primarily increased by a decrease in prepaid expenses and other current assets and an increase in accounts payable partially offset by a decrease in accrued expenses and an increase in accounts receivable. The $1.5 million decrease in prepaid expenses and other current assets was primarily due to the amortization of a fixed marketing agreement and the settlement of escrow funds. The $1.0 million decrease in accrued expenses was primarily due to the payout of accrued compensation costs. The $1.0 million increase in accounts receivable was due to higher billing as a result of increased revenues and significant accounts with certain customers which were collected subsequent to June 30, 2003.

Net cash used in operating activities for the six months ended June 30, 2002 resulted primarily from the net loss for the period before non-cash charges, including recapitalization, restructuring and impairment of Autobytel.Europe, an increase in accounts receivable and decreases in accounts payable and accrued expenses partially offset by a decrease in prepaid expenses and other current assets.

Net cash used in investing activities was $5.1 million and $30.5 million for the six months ended June 30, 2003 and 2002, respectively. Cash used in investing activities in 2003 was related to the acquisition of AVV and the purchase of property and equipment. Cash used in investing activities in 2002 was primarily due to the deconsolidation of Autobytel.Europe, expenditures for capitalized software related to our new customer relationship management software, RPM, an investment in Autobytel Australia and the purchase of computer hardware and software.

Net cash provided by financing activities was $25.8 million and $0.2 million for the six months ended June 30, 2003 and 2002, respectively. Cash provided by financing activities in 2003 was due to proceeds received from the sale of common stock in a private placement, through our employee stock purchase plan and by the exercise of stock options. Cash provided by financing activities in 2002 was due to proceeds received from the sale of common stock through our employee stock purchase plan and by the exercise of stock options.

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 ability to increase the volume of purchase requests and transactions related to our Web sites,
- the amount and timing of cash collection and disbursements, and
- the cash portion of acquisition transactions and joint ventures.

We maintain allowances for doubtful accounts and customer credits. The allowance for doubtful accounts is our estimate of bad debt expense that could result from the inability or refusal of our customers to pay for our services. The estimated provision for doubtful accounts is charged to operating expenses. The allowance for customer credits is our estimate of adjustments for purchase requests or other services that do not meet our customers' quality expectations. The estimated provision for customer credits is recorded as a reduction in revenue. Our estimates are based on our historical bad debt expense and customer credit experience.

In prior periods, significant increases in required allowances for doubtful accounts and customer credits have been recorded and may occur in the future. 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 allowances for doubtful accounts 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, other than an outstanding balance of $0.1 million related to capital leases at AVV. 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.

Our contractual commitments primarily consist of operating leases related to our facilities in Irvine, California and Westborough, Massachusetts, capital leases for office equipment and vendor contracts supporting our advertising efforts and our technology and communications infrastructure. The following are our contractual commitments associated with our lease obligations and vendor obligations as of June 30, 2003:

	Six Months Ending December 31,	Years Ending December 31,					
	2003	2004	2005	2006	2007	Thereafter	Total
Operating leases	$ 414	$ 998	$140	$ 18	$ 18	$ 1	$1,589
Capital leases	60	85	19	—	—	—	164
Online advertising	149	13	—	—	—	—	162
Hosting and communication	209	336	73	—	—	—	618
Data licensing	287	32	—	—	—	—	319
Other	39	23	—	—	—	—	62
Total	$ 1,158	$1,487	$232	$ 18	$ 18	$ 1	$2,914

With respect to periods beyond the second quarter of 2004, we may be required to raise additional capital to meet our long term operating requirements. Since inception, we have experienced annual operating losses and have an accumulated deficit of $159.2 million as of June 30, 2003. Failure to generate sufficient revenues, raise additional capital or reduce discretionary spending could have a material adverse effect on our ability to achieve our intended business objectives. We expect to be able to fund our operations from internally generated funds for at least the next 12 months. However, we cannot assure that we will be able to fund our operations from internally generated funds during such period or thereafter.

While we forecast and budget cash requirements, assumptions underlying the estimates may change and could have a material impact on our cash requirements. If capital requirements 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.

Any additional equity financing may be dilutive to our stockholders, and debt financing, if available, may involve restrictive covenants with respect to dividends, raising capital and other financial and operational matters which could restrict our operations or finances. If we are unable to obtain additional financing as needed or on terms favorable to us, we may be required to reduce the scope of or discontinue our operations or delay or discontinue any expansion, which could have a material adverse effect on our business, results of operations and financial condition.

Recent Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. We adopted SFAS No. 143 on January 1, 2003. The adoption did not have a material effect on our financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. We adopted SFAS No. 146 on January 1, 2003. The adoption did not have a material effect on our financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. (FIN) 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others." FIN 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002; while the provisions of the disclosure requirements are effective for financial statements of interim or annual reports ending after December 15, 2002. We adopted the disclosure requirements on December 31, 2002 and the recognition and measurement provisions on January 1, 2003. The adoption of FIN 45 did not have a material effect on our financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" which amends SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires prominent disclosure about the method of accounting and the effect of the method used on reported results in both annual and interim financial statements. SFAS No. 148 is effective for fiscal years ending after December 15, 2002 and interim periods beginning after December 15, 2002. We adopted SFAS No. 148 on January 1, 2003 and have elected to continue to account for our stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees."

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities," an Interpretation of Accounting Research Bulletin No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. We do not expect the adoption of FIN 46 to have a material effect on our 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 for the last three quarters and otherwise have a history of net losses and cannot assure that we will continue to be profitable. If we are unable to sustain our recent profitability 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. Having achieved profitability in the fourth quarter of 2002, we might fail to sustain or increase that profitability in the future. We cannot assure that we will be profitable. Autobytel had an accumulated deficit of $159.2 million as of June 30, 2003 and $161.2 million as of December 31, 2002.

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 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,
- 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.

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 program and enterprise dealers. A few agreements account for 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. If dealer attrition increases and we are unable to add new dealers to mitigate the attrition, our revenues will decrease. A material factor affecting dealer attrition is our ability to provide dealers with high quality purchase requests. 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, our revenues will decrease and our business, results of operations and financial condition will be materially and adversely affected.

Generally, our dealer agreements have a stated term ranging from 90 days to one year, but the dealer agreements are cancelable by the dealer upon 30 days notice. In the first quarter of 2003 we began an effort to sign new dealers to contracts with an initial term in excess of 30 days that are terminable on 30 days’ notice by us and automatically renew unless either party elects not to renew. Participating 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 dealers will not terminate their agreements with us. Our business is dependent upon our ability to attract and retain qualified new and used vehicle 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 would materially and adversely affect our business, results of operations and financial condition.

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

If the volume of purchase requests increases, we may need to reduce or reconfigure exclusive territories currently assigned to Autobytel or CarSmart dealers to serve consumers more effectively. If a dealer is unwilling to accept a reduction or reconfiguration of its territory, it may terminate its relationship with us. A dealer also could sue to prevent such reduction or reconfiguration, or collect damages from us. We have experienced one such lawsuit. A material decrease in the number of dealers participating in our networks or litigation with dealers 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 dealers in practices that are intended to increase consumer satisfaction. Our inability to train 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 new, and competition among commercial Web sites may increase significantly in the future. 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. 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 AutoUSA, Microsoft Corporation’s MSN Autos, CarsDirect.com, Cars.com, eBayMotors.com, AutoNation and AutoTrader.com. We also compete with vehicle dealers that are not part of our networks. Such companies 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. Our recently announced customer relationship management product, RPM, competes with companies that provide marketing services to automotive manufacturers and dealers, including Reynolds and Reynolds, Automatic Data Processing, 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,
- speed and quality of fulfillment,
- dealer territorial coverage,
- relationships with automotive manufacturers,
- variety of related 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 automobile 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,
- 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.

We expect our business to experience seasonality as it matures. 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. If 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.

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 our 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 and interest rates in regional and local markets). In addition, 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 or a general tightening of lending may affect us more significantly than companies in other industries.

Zero percent financing offered by manufacturers in 2002 may negatively affect vehicle sales in 2003. Consumers may have shifted their planned vehicle purchases from 2003 to 2002. 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 would 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 service. 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 service and may terminate their relationships with us or force us to decrease the fees we charge for our services. If our 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 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 and CarSmart.com 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. The growth of our operations 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 intend to continue to 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 other 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 dealership 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.

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 iManager 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 iManager systems, or other proprietary technology to customer requirements or to emerging industry standards.

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.

We presently host our production Web sites and certain systems, including Autobytel.com, Autoweb.com, CarSmart.com, AutoSite.com, AVV.com, RPM and iManager, at secure hosting facilities in Irvine, California and Columbus, Ohio. 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.

As a result of a variety of factors, available electricity supply in California may not be sufficient to meet demand at all times in some areas, and these constraints may continue for several years. The supply constraints have been managed, and will likely continue to be managed, by a combination of obtaining additional supplies, requested conservation, interruption of certain customers whose rates include that possibility, and as a last resort, interruption of some or all customers in certain areas through “rolling blackouts.” Relieving the supply constraints is likely to cause increases in the retail rates to be paid. Our main production systems are hosted in a secure facility with generators and other alternate power supplies in case of a power outage. However, our corporate offices, where we maintain our accounting, finance and contract management systems, are vulnerable to wide-scale power outages. To date, we have not been significantly affected by rolling black-outs or other interruptions in service related to the constraints on electricity supply. In the event we are affected by increased electricity rates or interruptions due to electricity supply constraints, our business, results of operations and financial condition could be materially and adversely affected.

We maintain business interruption insurance which pays up to $12.5 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 new and evolving with few profitable business models. We cannot assure that our business model will be profitable.

The market for Internet-based purchasing services has only recently begun to develop and is rapidly evolving. While many Internet commerce companies have grown in terms of revenues, few are profitable. We cannot assure that we will be profitable. 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 new and evolving, it is difficult to predict the future growth rate, if any, and size of this market. The extent to which other participants in the automotive industry will accept the role of third party all make, all model services like us is not yet known.

If consumers do not adopt Internet commerce as a mainstream medium of commerce or if automotive industry participants resist 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 that widespread acceptance of Internet commerce in general, or of our services in particular, will occur or that automotive companies will continue to accept a role for third party services such as ours. 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 accept new methods of conducting business and exchanging information and that automotive manufacturers will accept, rather than resist, a role for all make, all model third party sites such as ours that allow for comparisons. In addition, dealers must be persuaded 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 achieve market acceptance, our business, results of operations and financial condition will 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 the 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,
- conditions and trends in the Internet and electronic commerce industries,
- 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 and may continue to adversely affect the market price of our common stock. In addition, general economic, political and market conditions, such as recessions, interest rates, 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 financial condition.

Our licensees currently have Web sites in the United Kingdom, Sweden, The Netherlands and Japan. We may expand our brand into other foreign markets primarily through licensing our trade names. We cannot be certain that we will be successful in introducing or marketing our services abroad. 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. As a result, our results of operations and financial condition may be adversely affected.

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 who is able to circumvent our security measures could misappropriate proprietary 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 prove to be a viable commercial medium because of inadequate development of the necessary infrastructure, timely development of complementary products such as high speed modems, 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 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, 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 in the future to enforce or protect our intellectual property rights or to defend against claims or infringement or invalidity. Misappropriation of our intellectual property or potential litigation could 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 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. In this regard, a third-party asserted that we infringe certain of its patents. We initiated legal action to declare that no such infringement exists. 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.

Sales or the perception of future sales of our common stock may depress our stock price. Because the market prices for Internet related stocks are likely to remain volatile, our stock price may be more adversely affected than other companies by such future sales.

Sales of substantial numbers of shares of our common stock in the public market, or the perception that significant sales are likely, could adversely affect the market price of our common stock. Other than 71,109 shares that are held in escrow until December 4, 2004 and other than shares subject to lock up restrictions that were issued in connection with the acquisition of AVV, all of the shares issued in the private placement and in connection with the acquisition of AVV are available for sale, and this number of shares is greater than the average trading volume for our shares. No prediction can be made as to the effect, if any, that market sales of such shares will have on the market price of our common stock. Sales of substantial amounts of such shares in the public market could adversely affect the market price of our common stock.

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.

If we are unable to maintain our Nasdaq National Market listing, the liquidity of our common stock would be seriously limited.

We cannot assure that we will be able to comply with the minimum requirements for continued listing on the Nasdaq National Market. In the event our shares are delisted from the Nasdaq National Market, we anticipate that we would attempt to have our common stock traded on the NASD over-the counter Bulletin Board. If our common stock is delisted, it would seriously limit the liquidity of our common stock and limit our potential to raise future capital through the sale of our common stock, which could have a material adverse effect on our business.

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 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 fund more rapid expansion, to develop new or enhance existing services or products, to respond to competitive pressures or to acquire complementary products, businesses or technologies. 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 fund our expansion, take advantage of potential acquisition opportunities, 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 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 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. Such charter 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 report. The cautionary statements made in this report should be read as being applicable to all forward-looking statements wherever they appear in this report.

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

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of June 30, 2003. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures provide reasonable assurance that material information required to be included in our periodic reports filed with the Securities and Exchange Commission is timely accumulated and communicated to our management, including the principal executive officer and principal financial officer, to allow timely decisions regarding disclosure. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

On a regular basis, we review and modify our internal controls and procedures. There have been no significant changes (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal controls and procedures during our fiscal quarter ended June 30, 2003.

PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

On October 10, 2002, Morrison & Foerster LLP, a law firm that represented Autobytel, A.I.N., Inc. and Michael Gorun, former President of A.I.N., at various points in litigation which was settled in 2002, filed an action entitled Morrison & Foerster LLP v. Autobytel.com Inc. et al. in the Santa Clara Superior Court against Autobytel, A.I.N. and Mr. Gorun asserting claims for damages for beach of contract for failure to pay legal fees and expenses plus interest accrued thereon in the aggregate amount of approximately $660,000. On July 15, 2003, Autobytel, A.I.N. and Morrison & Foerster LLP settled the matter described above. The settlement amount was accrued as of June 30, 2003 and paid in July 2003.

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. Autobytel has approved a Memorandum of Understanding (“MOU”) and related agreements which set forth the terms of a settlement between Autobytel and the plaintiff class. It is anticipated that any potential financial obligation of Autobytel to plaintiffs due pursuant to the terms of the MOU and related agreements will be covered by existing insurance. Therefore, we do not expect that the settlement will involve payment by Autobytel. The MOU and related agreements are subject to a number of contingencies, including the approval of the MOU by a sufficient number of the other approximately 300 companies who are part of the consolidated case, the negotiation of a settlement agreement, and approval by the court. We cannot determine whether or when a settlement will occur or be finalized and whether the outcome of the litigation will have a material impact on our results of operations or financial condition 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, 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. Autoweb has approved the MOU and related agreements which set forth the terms of a settlement between Autoweb and the plaintiff class. It is anticipated that any potential financial obligation of Autoweb to plaintiffs due pursuant to the terms of the MOU and related agreements will be covered by existing insurance. Therefore, we do not expect that the settlement will involve payment by Autoweb. The MOU and related agreements are subject to a number of contingencies, including the approval of the MOU by a sufficient number of the other approximately 300 companies who are part of the consolidated case, the negotiation of a settlement agreement, and approval by the court. We cannot determine whether or when a settlement will occur or be finalized and whether the outcome of the litigation will have a material impact on our results of operations or financial condition in any future period.

On February 28, 2003, a purported class action lawsuit was filed in the United States District Court for the Southern District of Florida. The complaint named Autoweb, the former Chief Executive Officer and the former Chief Financial Officer of Autoweb, and CSFB, the co-lead underwriter of Autoweb's initial public offering, as defendants. The complaint alleged claims against Autoweb and such former officers for violations of the Securities Act of 1933, Securities Exchange Act of 1934, and Florida's Blue Sky laws and also alleged claims based on common law theories of fraud, negligent misrepresentation and respondeat superior. The complaint made similar allegations against approximately 50 other companies for which CSFB was the lead or a co-lead underwriter. The complaint alleged that the defendants disseminated false and misleading information to the public which misrepresented the accuracy of Autoweb's initial public offering price, its financial condition and future revenue prospects. The complaint further alleged that the effect of the purported fraud was to manipulate Autoweb's stock price so that the defendants could profit from the manipulation. The action sought damages in an unspecified amount. On June 19, 2003, an amended complaint was filed in this action. The amended complaint states that plaintiffs have voluntarily dismissed Autoweb as a defendant without prejudice.

We have reviewed the above class action matters and have determined that a reserve for loss contingencies is not required at this time.

From time to time, we are involved in other litigation matters relating to claims arising out of the ordinary course of business. We believe that there are no claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on our business, results of operations and financial condition. However, if a court or jury rules against us and the ruling is ultimately sustained on appeal and damages are awarded against us, such ruling could have a material and adverse effect on our business, results of operations and financial condition.

Item 2. *Changes in Securities and Use of Proceeds*

On June 24, 2003, we sold 5,000,000 shares of common stock in a private placement to institutional investors for gross proceeds of $27 million, or $5.40 per share. The offers and sales were exempt from registration under Rule 506 of Regulation D under the Securities Act of 1933, as amended, as all the purchasers were accredited investors.

On June 4, 2003, in connection with, and as partial consideration for, our acquisition of Applied Virtual Vision, Inc., we issued 711,109 shares of common stock to the three shareholders of such entity, all of which were accredited investors. The offers and sales were exempt from registration under Rule 506 of Regulation D under the Securities Act of 1933, as amended.

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

Autobytel held its Annual Meeting of Stockholders on June 25, 2003. The following is a brief description of each matter voted upon at the meeting and the number of votes cast for, withheld or against and, if applicable, the number of abstentions and broker non-votes with respect to each matter. Each director proposed by Autobytel was elected and the other three matters submitted for stockholder vote were approved.

(a) The stockholders reelected the three nominees for Autobytel's board of directors:

Director	For	Withheld Authority
Mark N. Kaplan	25,303,704	2,076,774
Richard A. Post	25,303,709	2,074,769
Mark R. Ross	25,303,709	2,076,769

The term of office as director for Jeffrey H. Coats, Michael J. Fuchs, Robert S. Grimes and Jeffrey A. Schwartz continued after the meeting.

(b) The stockholders approved the amendment to the Auto-By-Tel Corporation 1996 Employee Stock Purchase Plan:

For	Against	Abstain	Broker Non-Votes
7,849,808	533,583	148,170	18,848,917

(c) The stockholders approved the Autobytel Inc. Amended and Restated 2001 Restricted Stock and Option Plan.

For	Against	Abstain	Broker Non-Votes
5,671,979	2,700,089	159,493	18,848,917

(d) The stockholders approved the appointment of PricewaterhouseCoopers LLP as independent public auditors for fiscal 2003.

For	Against	Abstain
25,934,569	1,419,130	26,799

Item 6. ***Exhibits and Reports on Form 8-K***

(a) *Exhibits:*

2.1 Acquisition Agreement, dated as of June 4, 2003, among Autobytel Inc., Autobytel Acquisition, Inc., Applied Virtual Vision, Inc. and the shareholders of such entity is incorporated herein by reference to Exhibit 2 of the Form 8-K filed with the Securities and Exchange Commission ("SEC") on June 5, 2003.

10.1 Form of Subscription Agreement, dated June 24,2003, between Autobytel Inc. and the private placement investors is incorporated herein by reference to Exhibit 10.1 of the Registration Statement on Form S-3 (File No. 333-107152) filed with the SEC on July 18, 2003.

10.2 Autobytel Inc. Amended and Restated 2001 Restricted Stock and Option Plan is incorporated herein by reference to Exhibit 4.7 of the Registration Statement on Form S-8 (File No. 333-67692) filed with the SEC on July 31, 2003.

10.3 Amendment No. 1 to Auto-By-Tel Corporation 1996 Employee Stock Purchase Plan is incorporated herein by reference to Exhibit 4.8 of the Registration Statement on Form S-8 (File No. 333-107525) filed with the SEC on July 31, 2003.

31.1 Chief Executive Officer Section 302 Certification of Periodic Report, dated August 12, 2003.

31.2 Chief Financial Officer Section 302 Certification of Periodic Report, dated August 12, 2003.

32.1 Chief Executive Officer and Chief Financial Officer Section 906 Certification of Periodic Report, dated August 12, 2003.

(b) *Reports on Form 8-K:*

On April 25, 2003, we filed a Form 8-K dated April 24, 2003 announcing our financial results for the quarter ended March 31, 2003.

On April 29, 2003, we filed a Form 8-K dated April 24, 2003 which included a transcript of a telephone conference call that was webcast in conjunction with the announcement of our financial results for the quarter ended March 31, 2003.

On June 5, 2003, we filed a Form 8-K dated June 4, 2003 announcing the acquisition of Applied Virtual Vision, Inc.

On June 25, 2003, we filed a Form 8-K dated June 24, 2003 announcing the sale of 5,000,000 newly-issued shares of common stock to a group of institutional investors in a private placement.

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/ HOSHI PRINTER

Hoshi Printer
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

By: /s/ AMIT KOTHARI

Amit Kothari
Vice President and Controller
(Principal Accounting Officer)

Date: August 12, 2003

EXHIBIT INDEX

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10.3	Amendment No. 1 to Auto-By-Tel Corporation 1996 Employee Stock Purchase Plan is incorporated herein by reference to Exhibit 4.8 of the Registration Statement on Form S-8 (File No. 333-107525) filed with the SEC on July 31, 2003.
31.1	Chief Executive Officer Section 302 Certification of Periodic Report, dated August 12, 2003.
31.2	Chief Financial Officer Section 302 Certification of Periodic Report, dated August 12, 2003.
32.1	Chief Executive Officer and Chief Financial Officer Section 906 Certification of Periodic Report, dated August 12, 2003.

EXHIBIT 31.1

CERTIFICATION

I, Jeffrey A. Schwartz, 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)) for the registrant and we 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) 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

c) 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: August 12, 2003

/s/ JEFFREY A. SCHWARTZ

Jeffrey A. Schwartz,
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Hoshi Printer, Executive Vice President and 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)) for the registrant and we 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) 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

c) 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: August 12, 2003

/s/ HOSHI PRINTER

Hoshi Printer,
Executive Vice President and Chief 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 June 30, 2003 (the " Report "), we, Jeffrey A. Schwartz, Chief Executive Officer of the Company, and Hoshi Printer, 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 results of operations of the Company.

/s/ Jeffrey A. Schwartz

Jeffrey A. Schwartz
Chief Executive Officer
August 12, 2003

/s/ Hoshi Printer

Hoshi Printer
Chief Financial Officer

August 12, 2003

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.