AUTOBYTEL INC

FORM 10-Q
(Quarterly Report)

Filed 08/09/06 for the Period Ending 06/30/06

Address	18872 MACARTHUR BLVD SUITE 200 IRVINE, CA 92612-1400
Telephone	9492254500
CIK	0001023364
Symbol	ABTL
SIC Code	7370 - Computer Programming, Data Processing, And
Industry	Advertising
Sector	Services
Fiscal Year	12/31

http://www.edgar-online.com
© Copyright 2010, EDGAR Online, Inc. All Rights Reserved.
Distribution and use of this document restricted under EDGAR Online, Inc. Terms of Use.

Table of Contents

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, 2006

or

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

For the transition period from _____to _____.

Commission file number 0-22239

Autobytel Inc.

(Exact name of registrant as specified in its charter)

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

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

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

As of August 1, 2006, there were 42,449,764 shares of the Registrant's Common Stock outstanding.

INDEX

		Page
	PART I. FINANCIAL INFORMATION	
ITEM 1.	Condensed Consolidated Financial Statements (unaudited):	
	Condensed Consolidated Balance Sheets as of June 30, 2006 and December 31, 2005	3
	Condensed Consolidated Statements of Operations and Comprehensive Loss for the Three Months and Six Months Ended June 30, 2006 and 2005	4
	Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2006 and 2005	5
	Notes to Condensed Consolidated Financial Statements	6
ITEM 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
ITEM 3.	Quantitative and Qualitative Disclosures About Market Risk	28
ITEM 4.	Controls and Procedures	28
	PART II. OTHER INFORMATION	
ITEM 1.	Legal Proceedings	29
ITEM 1A.	Risk Factors	32
ITEM 4.	Submission of Matters to a Vote of Security Holders	47
ITEM 6.	Exhibits	47
Signatures		48

Table of Contents

PART I. FINANCIAL INFORMATION

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

AUTOBYTEL INC.

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

	June 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Domestic cash and cash equivalents	$ 29,177	$ 33,353
Restricted international cash and cash equivalents	244	241
Short-term investments	8,959	12,000
Accounts receivable, net of allowances for bad debts and customer credits of $821 and $1,124, respectively	17,936	19,042
Prepaid expenses and other current assets	2,750	2,456
Total current assets	59,066	67,092
Long-term investments	—	3,000
Property and equipment, net	4,254	4,226
Goodwill	70,697	70,697
Acquired intangible assets, net	1,409	2,189
Other assets	86	124
Total assets	$ 135,512	$ 147,328
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,572	$ 5,709
Accrued expenses	6,499	7,417
Deferred revenues	4,187	3,874
Other current liabilities	1,746	1,666
Total current liabilities	20,004	18,666
Deferred rent—non-current	169	131
Deferred revenues—non-current	—	21
Total liabilities	20,173	18,818
Minority interest	158	163
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 11,445,187 shares authorized; none outstanding	—	—
Common stock, $0.001 par value; 200,000,000 shares authorized; 42,354,204 and 42,133,410 shares issued and outstanding, respectively	42	42
Additional paid-in capital	286,089	282,924
Accumulated deficit	(170,950)	(154,619)
Total stockholders' equity	115,181	128,347
Total liabilities, minority interest and stockholders' equity	$ 135,512	$ 147,328

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

Table of Contents

AUTOBYTEL INC.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues	$ 29,372	$ 31,385	$ 58,444	$ 64,713
Costs and expenses:				
Cost of revenues	14,423	12,682	29,212	26,069
Sales and marketing	7,307	7,008	14,840	15,090
Product and technology development	6,183	6,279	11,807	12,350
General and administrative	9,456	8,539	19,159	16,867
Amortization of acquired intangible assets	353	354	710	814
Total costs and expenses	37,722	34,862	75,728	71,190
Loss from operations	(8,350)	(3,477)	(17,284)	(6,477)
Interest income	472	389	943	738
Foreign currency exchange gain	2	8	5	10
Loss before income taxes and minority interest	(7,876)	(3,080)	(16,336)	(5,729)
Provision for income taxes	—	(127)	—	(271)
Minority interest	8	(76)	5	(93)
Net loss	$ (7,868)	$ (3,283)	$ (16,331)	$ (6,093)
Net loss per share — basic and diluted	$ (0.19)	$ (0.08)	$ (0.39)	$ (0.15)
Shares used in computing net loss per share — basic and diluted	42,337,302	41,906,851	42,265,226	41,906,352
Comprehensive loss:				
Net loss	$ (7,868)	$ (3,283)	$ (16,331)	$ (6,093)
Foreign currency translation adjustment	—	(249)	—	(314)
Comprehensive loss	$ (7,868)	$ (3,532)	$ (16,331)	$ (6,407)

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

Table of Contents

AUTOBYTEL INC.

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

	Six Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net loss	$(16,331)	$ (6,093)
Adjustments to reconcile net loss to net cash used in operating activities:		
Non-cash charges:		
Depreciation and amortization	1,065	1,048
Amortization of acquired intangible assets	780	976
Provision for bad debt	63	342
Provision for customer credits	974	1,482
Write-off of capitalized internal use software	264	—
Loss on disposal of property and equipment	3	2
Stock-based compensation	2,484	—
Minority interest	(5)	93
Foreign currency exchange gain	(3)	—
Changes in assets and liabilities:		
Accounts receivable	69	(3,142)
Prepaid expenses and other current assets	(294)	(728)
Other assets	38	5
Accounts payable	1,863	1,032
Accrued expenses	(918)	(1,492)
Deferred revenues	292	150
Accrued domestic restructuring	—	(74)
Other liabilities	118	(31)
Net cash used in operating activities	(9,538)	(6,430)
Cash flows from investing activities:		
Maturities of short-term and long-term investments	9,000	18,600
Purchases of short-term and long-term investments	(2,959)	(8,100)
Change in restricted international cash and cash equivalents	—	(168)
Purchases of property and equipment	(1,373)	(1,126)
Proceeds from sale of property and equipment	13	6
Net cash provided by investing activities	4,681	9,212
Cash flows from financing activities:		
Proceeds from exercise of stock options and awards issued under the employee stock purchase plan	681	16
Net cash provided by financing activities	681	16
Net (decrease) increase in cash and cash equivalents	(4,176)	2,798
Cash and cash equivalents, beginning of period	33,353	24,287
Cash and cash equivalents, end of period	$ 29,177	$27,085
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	$ 316	$ 534

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

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Organization and Operations of Autobytel

Autobytel Inc. (the "Company" or "Autobytel") is an automotive marketing services company that helps dealers sell cars and manufacturers build brands through efficient marketing and advertising primarily through the Internet. The Company owns and operates automotive Web sites, including Autobytel.com, Autoweb.com, Car.com, CarSmart.com, AutoSite.com, AICAutoSite.com, Autoahorros.com and CarTV.com. The Company is among the largest syndicated car buying content networks and reaches millions of Internet visitors as they make their vehicle buying decisions. The Company is also a leading provider of customer relationship management ("CRM") products and programs consisting of lead management products, customer loyalty and retention marketing programs, data extraction services and automotive marketing data and technology.

The Company is a Delaware corporation incorporated on May 17, 1996. Its principal corporate offices are located in Irvine, California. The Company's common stock is listed on the NASDAQ Global Market under the symbol ABTL.

2. Summary of Significant Accounting Polices

Unaudited Interim Financial Statements

In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements contain all adjustments necessary (consisting only of normal recurring accruals) to present fairly the financial information contained therein. These statements do not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP") for annual periods and should be read in conjunction with the Company's audited consolidated financial statements and related notes for the year ended December 31, 2005 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on March 16, 2006. The Company prepared the unaudited interim condensed consolidated financial statements following the requirements of the SEC for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted. The results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results to be expected for the year ending December 31, 2006 or any other period(s).

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires the Company 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.

Stock Based Compensation Expense

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), "Share-Based Payments," which is a revision to SFAS No. 123, "Accounting for Stock-Based Compensation" issued in 1995, using the modified prospective method and therefore has not restated prior periods' results. Under the fair value recognition provisions of SFAS No. 123(R), the Company recognizes stock-based compensation net of an estimated forfeiture rate and therefore only recognizes compensation cost for those shares expected to vest over the service period of the award. Prior to SFAS No. 123(R) adoption, the Company accounted for share-based payments under APB Opinion No. 25 and, accordingly, generally recognized no compensation expense related to share-based awards as awards were generally granted at fair value at the date of grant and accounted for forfeitures as they occurred.

Calculating stock-based compensation expense requires the input of highly subjective assumptions, including the expected term of the stock-based awards, stock price volatility, and pre-vesting option forfeitures. The Company estimates the expected life of options granted based on historical exercise patterns, which it believes are representative of future behavior, using a lattice expected term model. The Company estimates the volatility of its common stock at the date of grant based on historical volatility of its common stock for a period equal to the expected term of the awards. The assumptions used in calculating the fair value of stock-based awards represent its best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and the Company uses different assumptions, stock-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. The Company estimates the

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

forfeiture rate based on historical experience of its stock-based awards that are granted, exercised and cancelled. If its actual forfeiture rate is materially different from its estimate, the stock-based compensation expense could be significantly different from what it has recorded in the current period. See Note 4 — "Stock-Based Compensation" in the condensed consolidated financial statements for additional information.

Revenue Recognition

The Company classifies revenues as lead fees, advertising, CRM services, and data, applications and other. Revenues by groups of services are as follows for the three and six months ended June 30, 2006 and 2005 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues:				
Lead fees	$17,759	$19,699	$35,748	$41,324
Advertising	4,311	4,497	8,090	9,258
CRM services	6,342	6,040	12,681	11,798
Data, applications and other	960	1,149	1,925	2,333
Total revenues	$29,372	$31,385	$58,444	$64,713

The Company recognizes revenues when earned as defined by Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," and Emerging Issues Task Force ("EITF") Issue 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." SAB No. 104 considers revenue realized after all four of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the seller's price to the buyer is fixed or determinable and (iv) collectibility is reasonably assured.

In accounting for multiple-element arrangements, one of the key judgments to be made is the accounting value that is attributable to the different contractual elements. The appropriate allocation of value not only impacts which revenue stream is credited with the revenue, it also impacts the amount and timing of revenue recorded in the consolidated statement of operations during a given period due to the differing methods of recognizing revenue. Revenue is allocated to each element based on the accounting determination of the relative fair value of that element to the aggregate fair value of all elements. The fair values must be reliable, verifiable and objectively determinable. When available, such determination is based principally on the pricing of similar cash arrangements with unrelated parties that are not part of a multiple-element arrangement. When sufficient evidence of the fair values of the individual elements does not exist, revenue is not allocated among them until that evidence exists. Instead, the revenue is recognized as earned using revenue recognition principles applicable to the entire arrangement as if it were a single element arrangement.

As of June 30, 2006, the Company deferred revenue in accordance with EITF Issue 00-21 under two multiple-element arrangements. At June 30, 2006 and December 31, 2005 deferred revenue related to these arrangements totaled $657,000 and $300,000, respectively. Revenue recognized under these arrangements totaled $509,000 and $762,000 for the three and six months ended June 30, 2006.

Risk Due to Concentration of Significant Customers and Export Sales

The Company had no balances owed from any single automotive manufacturer that accounted for more than 10% of total accounts receivable as of June 30, 2006. The Company had balances owed from two automotive manufactures that each accounted for more than 10% of total accounts receivable as of December 31, 2005.

Business Segment

The Company conducts its business within one business segment which is defined as providing automotive marketing services.

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle. It also requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 on January 1, 2006, and its adoption did not have a material effect on the Company's condensed consolidated financial position or results of operations.

In July 2006, FASB issued FIN 48 "Accounting for Uncertainty in Income Taxes" which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. It also provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for the Company beginning January 1, 2007. The Company is currently evaluating the impact of adopting FIN 48 on its consolidated financial statements.

3. Computation of Basic and Diluted Net Loss Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(in thousands, except share and per share data)			
Numerator:				
Net loss	$ (7,868)	$ (3,283)	$ (16,331)	$ (6,093)
Denominator:				
Weighted average common shares and denominator for basic and diluted calculation	42,337,302	41,906,851	42,265,226	41,906,352
Net loss per share—basic and diluted	$ (0.19)	$ (0.08)	$ (0.39)	$ (0.15)

For the three and six months ended June 30, 2006, 7,251,914 and 7,264,833 antidilutive potential shares of common stock, consisting of employee and director stock options and employee stock purchase plan awards, have been excluded from the calculation of diluted net loss per share, as the Company incurred a net loss for the period. For the three and six months ended June 30, 2005, 7,944,035 and 7,866,917 antidilutive potential shares of common stock, consisting of employee and director stock options and employee stock purchase plan awards, have been excluded from the calculation of diluted net loss per share, as the Company incurred a net loss for the period.

4. Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R) using the modified prospective application method. Under this transition method, compensation cost recognized for the three months and six months ended June 30, 2006, includes the applicable amounts of: (a) compensation cost of all stock-based payments granted prior to, but not yet vested as of December 31, 2005 (based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123 and previously presented in the pro forma footnote disclosures), and (b) compensation cost for all stock-based payments granted subsequent to December 31, 2005 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123(R)). Results from prior periods have not been restated.

The Company has several stock-based compensation plans, which are more fully described in Note 9 of the Consolidated Financial Statements of the Company included in its Annual Report on Form 10-K for the year ended December 31, 2005.

In June 2006, the Autobytel Inc. 2006 Inducement Stock Option Plan (the "2006 Plan") was approved by the Board of Directors. The 2006 Plan provides that an aggregate of 2,000,000 shares of Autobytel's common stock are available to be awarded to Autobytel's newly hired employees or appointed directors, solely in connection with the hiring of the employee or appointing of the director, in the form of nonqualified stock options. The per share exercise price of the stock options shall not be less than 100% of the fair market value of a share on the date of grant. No option shall be exercisable after the expiration of

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

ten years from its grant date. An optionee who is not an officer or a director must have the right to exercise at least 20% of the options granted per year over five years from the date of grant. Unless the award agreement provides differently, the unvested portion of the awards will immediately become vested upon any merger (other than a merger in which the Company is the surviving entity and the terms remain unchanged as compared to the terms prior to the merger), consolidation, or sale or transfer of the Company's assets, except if the options are assumed by the acquiring party. Unless the award agreement provides differently, upon any liquidation or dissolution of the Company, all the rights to any portion of unvested awards will end, and the awards will be canceled at the time of the liquidation or dissolution unless the relevant dissolution or liquidation plan provides otherwise.

At June 30, 2006, 3,619,415 shares underlying stock options were available for grant under the Company's existing stock option plans. The Company grants incentive and non-qualified stock options at an exercise price equal to the market closing price at the date of grant and that vest according to vesting schedules determined by the Board of Directors or committee thereof. The Company utilizes the straight-line attribution method for recognizing stock-based compensation expense under SFAS No. 123(R). Shares of common stock issued upon exercise of stock options or awards under the employee stock purchase plan are from previously unissued shares. For the three months and six months ended June 30, 2006, the Company recorded $1,194,000 and $2,484,000 of stock-based compensation expense, or $0.03 and $0.06 earning per share, respectively. Stock-based compensation expense is included in costs and expenses in the accompanying condensed consolidated statement of operations for the three months and six months ended June 30, 2006 as follows:

	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006
	(in thousands)	
Cost of revenues	$ 43	$ 83
Sales and marketing	257	582
Product and technology development	194	391
General and administrative	700	1,428
	$ 1,194	$ 2,484

Prior to adopting SFAS No. 123(R) on January 1, 2006, the Company accounted for share-based compensation plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No compensation cost was reflected in the net loss for the three months and six months ended June 30, 2005 related to stock options, as all options granted under share-based compensation plans have an exercise price equal to the market closing price of the underlying common stock on the date of grant.

The following table illustrates the pro forma effect on net loss and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for the three months and six months ended June 30, 2005:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
	(in thousands, except per share data)	
Net loss:		
As reported	$ (3,283)	$ (6,093)
Less: Employee stock-based compensation determined under the fair value based method	(1,286)	(2,879)
Pro forma	$ (4,569)	$ (8,972)
Net loss per share—basic and diluted:		
As reported	$ (0.08)	$ (0.15)
Pro forma	$ (0.11)	$ (0.21)

Prior to the adoption of SFAS No. 123(R), the Company did not record any tax benefits resulting from the exercise of options due to uncertainty surrounding the timing of realizing the benefits of its deferred tax assets in future periods. SFAS No. 123(R) requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than an operating cash flow as required under APB No. 25. Had the Company recognized an excess tax benefit

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

from deductions resulting from the exercise of stock options, it would have classified the benefit as a financing cash inflow in the consolidated statement of cash flows.

The weighted-average fair market value per share of the options granted during the three months ended June 30, 2006 and 2005 was $2.12 and $2.58, respectively. The weighted-average fair market value per share of the options granted during the six months ended June 30, 2006 and 2005, was $2.76 and $2.58, respectively. The weighted-average fair market value of the stock options at the date of grant was estimated using the Black-Scholes option-pricing model on the date of grant and the following assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Dividend yield	0.00%	0.00%	0.00%	0.00%
Volatility	79.18%	71.94%	80.32%	71.94%
Weighted-average risk-free interest rate	5.05%	3.65%	4.83%	3.65%
Expected life	4.99 years	3.50 years	4.99 years	3.50 years

The risk-free interest rate is based on United States treasury yield for a term consistent with the expected life of the stock option in effect at the time of grant. The risk-free interest rate ranged from 4.90% to 5.07% and 4.35% to 5.07% for the three and six months ended June 30, 2006, respectively. Expected volatility is based on the Company's historical experience for a period equal to the expected life. Expected life is calculated using a lattice expected term model which utilizes historical data to calculate future behavior for the three months and six months ended June 30, 2006. Expected life for the three months and six months ended June 30, 2005 is based on historical exercise patterns. A dividend yield was not considered in the option-pricing formula since the Company has not paid dividends in the past and has no current plans to do so in the future. The forfeiture rate used was based on historical experience. As required by SFAS No. 123(R), the Company adjusts the estimated forfeiture rate based on actual experience.

There were no awards issued under the employee stock purchase plan during the three months ended June 30, 2006. Awards issued under the employee stock purchase plan were estimated to have a weighted-average fair value per award of $0.87 for the three months ended June 30, 2005. Awards issued under the employee stock purchase plan during the six months ended June 30, 2006 and 2005 were estimated to have a weighted average fair value of $1.15 and $0.87, respectively. The fair value of the awards is based on the Black-Scholes option-pricing model and the following assumptions:

	Three Months Ended June 30,	Six Months Ended June 30,	
	2005	2006	2005
Dividend yield	0.00%	0.00%	0.00%
Volatility	46.99%	53.42%	46.99%
Weighted-average risk-free interest rate	2.99%	4.60%	2.99%
Expected life	1.4 months	6 months	1.4 months

The weighted-average risk-free interest rate is based on United States treasury yield for a term consistent with the expected life of the award in effect at the time of grant. Expected volatility is based on the Company's historical experience for a period equal to the expected life. Expected life is based on the term of the offering period. A dividend yield was not considered in the option-pricing formula since the Company has not paid dividends in the past and has no current plans to do so in the future. The forfeiture rate used was based on historical experience. As required by SFAS No. 123(R), the Company adjusts the estimated forfeiture rate based on actual experience.

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

A summary of the Company's outstanding stock options as of June 30, 2006, and changes during the six months then ended is presented below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at December 31, 2005	8,638,681	$ 6.04		
Granted	1,190,500	4.11		
Exercised	(167,091)	2.75		
Forfeited	(580,904)	7.66		
Outstanding at June 30, 2006	9,081,186	$ 5.74	7.10	$ 3,800
Vested and expected to vest at June 30, 2006	7,760,348	$ 5.76	6.94	$ 3,720
Exercisable at June 30, 2006	6,218,114	$ 5.87	6.29	$ 3,597

The total intrinsic value of options exercised during the three months ended June 30, 2006 and 2005, was $21,000 and $9,000, respectively. The total intrinsic value of options exercised during the six months ended June 30, 2006 and 2005, was $279,000 and $9,000, respectively.

As of June 30, 2006, there was $5,319,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under share-based compensation plans. The cost is expected to be recognized over a weighted-average period of 1.02 years using the straight-line attribution method.

The Company also has awards outstanding under the 1996 Employee Stock Purchase Plan. At June 30, 2006, the awards outstanding under the 1996 Employee Stock Purchase Plan had an exercise price of $4.12 per share. Of the total outstanding awards, none were exercisable at June 30, 2006 or December 31, 2005.

A summary of the Company's outstanding awards under the employee stock purchase plan as of June 30, 2006, and changes during the period then ended is presented below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at December 31, 2005	68,012	$ 4.37		
Granted	65,985	4.12		
Exercised	(53,704)	4.12		
Forfeited	(14,308)	4.37		
Outstanding at June 30, 2006	65,985	$ 4.12	1 month	$ —
Vested and expected to vest at June 30, 2006	62,772	$ 4.12	1 month	$ —

As of June 30, 2006, there was $12,000 of total unrecognized compensation cost related to options granted under the employee stock purchase plan. The cost is expected to be recognized over 1 month using the straight-line attribution method.

On March 20, 2006, the Company entered into an agreement with James E. Riesenbach whereby the Company granted 1,000,000 options to him at an exercise price of $4.68. Of the 1,000,000 options granted, 600,000 were service-based awards and met the criteria for granted options in accordance with SFAS No. 123(R) as of March 20, 2006. The remaining 400,000 options are performance-based awards where the future performance criteria will be defined at a future date. As such, in accordance with SFAS No. 123(R), the awards are not considered granted until such time that the performance criteria have been defined and were not included in outstanding options at June 30, 2006. The Company will begin recognizing stock-based compensation expense based on the fair value of the performance-based options on the date the performance criteria have been defined.

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

5. Selected Balance Sheet Accounts

Short-Term and Long-Term Investments

At June 30, 2006 and December 31, 2005 the amortized cost basis, aggregate fair value, unrealized gains and losses by security type were as follows:

	Amortized Cost Basis	Aggregate Fair Value	Unrealized Gains	Unrealized Losses
		(in thousands)		
June 30, 2006:				
Short-term investments, held-to-maturity:				
Government sponsored agency bonds	$ 6,000	$ 5,944	$ —	$ 56
Commercial paper	2,959	2,959	—	—
Total as of June 30, 2006	$ 8,959	$ 8,903	$ —	$ 56
December 31, 2005:				
Short-term investments, held-to-maturity:				
Government sponsored agency bonds	$ 12,000	$11,901	$ —	$ 99
Long-term investments, held-to-maturity:				
Government sponsored agency bonds	3,000	2,964	—	36
Total as of December 31, 2005	$ 15,000	$14,865	$ —	$ 135

The maturities of investments as of June 30, 2006 are due within one year.

The longer the term of the securities the more susceptible they are to changes in market rates of interest and yields on bonds. The Company reviews its investments in debt securities for potential impairment on a regular basis. As part of the evaluation process, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and the Company's intent and ability to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. The Company has the intent and ability to hold these securities for a reasonable period of time sufficient for a forecasted recovery of fair value up to the initial cost of the investment. The Company expects to realize the full value of all of these investments upon maturity. The Company will record an impairment loss on investments for any other-than-temporary decline in fair value of these debt securities below their cost basis. The Company did not record any impairment losses that were related to other-than-temporary decline in fair value of its debt securities for the six months ended June 30, 2006 and 2005.

Capitalized Internal Use Software

The Company capitalizes costs to develop internal use software under the provisions of Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Development or Obtained for Internal Use." The Company periodically reviews and evaluates capitalized internal use software for indications that the software may no longer be expected to provide any service potential or placed in service for its intended use. During the three months ended June 30, 2006, the Company recorded a charge of $264,000 associated with the write-off of a capitalized internal use software project no longer being developed or expected to be placed in service for its intended use. This charge was included in products and technology expenses.

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

Acquired Intangible Assets

Acquired intangible assets at June 30, 2006 and December 31, 2005 are amortized over their estimated useful lives and consist of the following:

	As of June 30, 2006			
	Average Estimated Useful Lives	Gross Carrying Amount	Accumulated Amortization	Net Amount
		(in thousands)		
Developed technology	2 years	$ 820	$ (780)	$ 40
Customer relationships	3 years	4,375	(3,397)	978
Domain name	5 years	700	(309)	391
Total		$ 5,895	$ (4,486)	$1,409

	As of December 31, 2005			
	Average Estimated Useful Lives	Gross Carrying Amount	Accumulated Amortization	Net Amount
		(in thousands)		
Developed technology	2 years	$ 820	$ (710)	$ 110
Customer relationships	3 years	4,375	(2,757)	1,618
Domain name	5 years	700	(239)	461
Total		$ 5,895	$ (3,706)	$2,189

Amortization expense for the three and six months ended June 30, 2006 was $385,000 and $780,000, respectively. Amortization expense for the three and six months ended June 30, 2005 was $477,000 and $976,000, respectively. Amortization expense related to technology is classified as cost of revenues. Amortization expense for the remaining lives of the intangible assets is estimated to be as follows:

	Amortization Expense
	(in thousands)
Six months ending December 31, 2006	$ 733
2007	495
2008	140
2009	41
	$ 1,409

Accrued Liability for Realignment

In June 2006, the Board of Directors of the Company, at the recommendation of management, approved a realignment of its workforce, which included a reduction of its workforce by approximately 10% or 46 employees. The realignment was effected in order to generate operational efficiencies across the Company's product lines and to enable new investment in key growth areas. As a result, the Company recorded a $299,000 charge, consisting of severance costs, during the three months and six months ended June 30, 2006. This charge was included in sales and marketing expenses, product and technology expenses and general and administrative expenses of $102,000, $138,000 and $59,000 respectively. The Company paid $197,000 of the severance costs during the three months ended June 30, 2006. As of June 30, 2006, the remaining accrued liability related to this realignment was $102,000. The Company expects the remaining accrued liability to be paid in the third quarter of 2006.

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

6. Autobytel.Europe LLC

In December 2005, the owners of Autobytel.Europe agreed to dissolve Autobytel.Europe. As of June 30, 2006 and December 31, 2005, the assets and liabilities of Autobytel.Europe were as follows:

	June 30, 2006	December 31, 2005
	(in thousands)	
Restricted international cash and cash equivalents	$ 244	$ 241
Other current and non-current assets	120	138
Other current liabilities	(54)	(61)
Minority interest	(158)	(163)
	$ 152	$ 155

Autobytel.Europe did not generate any revenue for the three and six months ended June 30, 2006 as a result of the substantial liquidation in December 2005. Total revenue for the three and six months ended June 30, 2005 was $31,000 and $76,000, respectively.

7. Commitments and Contingencies

Litigation

In August 2001, a purported class action lawsuit was filed in the United States District Court for the Southern District of New York against Autobytel and certain of the Company's current and former directors and officers (the "Autobytel Individual Defendants") and underwriters involved in the Company's initial public offering. The complaints against the Company 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 the Company'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 the Company'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 the Company. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Underwriter Defendants sought leave to appeal this decision and the Second Circuit has accepted the appeal. Plaintiffs have not yet moved to certify a class in the Company case. The Company has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autobytel, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of the Company and the Autobytel Individual Defendants for the conduct alleged in the action to be wrongful. The Company would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. The settlement agreement also provides a guaranteed recovery of one billion dollars to plaintiffs for the cases relating to all of the approximately 300 issuers. On April 20, 2006, JPMorgan Chase and the plaintiffs reached a preliminary agreement for a settlement for $425 million. The JPMorgan Chase settlement has not yet been approved by the Court. However, if it is finally approved, then the maximum amount that the issuers' insurers will be potentially liable for is $575 million. To the extent that the underwriter defendants settle all of the cases for at least one billion dollars, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of the Company to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. The Company currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and the Company is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, the Company does not expect that the settlement will involve any payment by the Company. If material limitations on the expected recovery of any potential

AUTOBYTEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (continued)
(unaudited)

financial obligation to the plaintiffs from the Company's insurance carriers should arise, the Company's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. However, if the JPMorgan Chase settlement is finally approved, the Company's maximum financial obligation to the plaintiffs pursuant to the settlement agreement would be less than $2 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. On March 20, 2006, the Underwriter Defendants submitted objections to the settlement to the Court. The Court held a hearing regarding these and any other objections to the settlement at a fairness hearing on April 24, 2006, but it has not yet issued a ruling. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and the Company is found liable, the Company is unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than its insurance coverage, or whether such damages would have a material impact on its results of operations, financial condition or cash flows in any future period.

Between April and June 2001, eight separate purported class actions virtually identical to the one filed against Autobytel were filed against Autoweb.com, Inc. ("Autoweb"), certain of Autoweb's current and former directors and officers (the "Autoweb Individual Defendants") and underwriters involved in Autoweb's initial public offering. The complaints against Autoweb have been consolidated into a single action, and a Consolidated Amended Complaint, which is now the operative complaint, was filed on April 19, 2002. The foregoing action purports to allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Plaintiffs allege that the underwriter defendants agreed to allocate stock in Autoweb's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for Autoweb's initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The action seeks damages in an unspecified amount. The action is being coordinated with approximately 300 other nearly identical actions filed against other companies. A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Autoweb Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Autoweb Individual Defendants. On February 19, 2003, the Court dismissed the Section 10(b) claim without prejudice and with leave to replead but denied the motion to dismiss the claim under Section 11 of the Securities Act of 1933 against Autoweb. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Underwriter Defendants sought leave to appeal this decision and the Second Circuit has accepted the appeal. Plaintiffs have not yet moved to certify a class in the Autoweb case. Autoweb has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autoweb, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of Autoweb and the Autoweb Individual Defendants for the conduct alleged in the action to be wrongful. Autoweb would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims Autoweb may have against its underwriters. The settlement agreement also provides a guaranteed recovery of one billion dollars to plaintiffs for the cases relating to all of the approximately 300 issuers. On April 20, 2006, JPMorgan Chase and the plaintiffs reached a preliminary agreement for a settlement for $425 million. The JPMorgan Chase settlement has not yet been approved by the Court. However, if it is finally approved, then the maximum amount that the issuers' insurers will be potentially liable for is $575 million. To the extent that the underwriter defendants settle all of the cases for at least one billion dollars, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of Autoweb to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. Autoweb currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and Autoweb is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, the Company does not expect that the settlement will involve any payment by Autoweb. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from Autoweb's insurance carriers should arise, Autoweb's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. However, if the JPMorgan Chase settlement is finally approved, the Company's maximum financial obligation to the plaintiffs pursuant to the settlement agreement would be less than $2 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. On March 20, 2006, the Underwriter Defendants submitted objections to the settlement to the Court. The Court held a hearing regarding these and any other objections to the settlement at a fairness hearing on April 24, 2006, but it has not yet issued a ruling. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and Autoweb is found liable, the Company is unable to estimate or predict the potential damages that might be

awarded, whether such damages would be greater than Autoweb's insurance coverage, or whether such damages would have a material impact on the Company's results of operations, financial condition or cash flows in any future period.

The Company has reviewed the above class action matters and does not believe that it is probable that a loss contingency has occurred; therefore, the Company has not recorded a liability against these claims as of June 30, 2006.

On September 24, 2004, the Company filed a lawsuit in the United States District Court for the Eastern District of Texas against Dealix Corporation. In that lawsuit, the Company asserted infringement of U.S. Patent No. 6,282,517, entitled "Real Time Communication of Purchase Requests," against Dealix Corporation. The Company contended that Dealix Corporation is infringing the Company's patent by virtue of Dealix Corporation's software system for the distribution of purchase requests, and sought damages and/or a preliminary injunction. Dealix Corporation filed answers to this lawsuit on January 28, 2005, February 1, 2005 and July 19, 2005, in which it asserts typical defensive counterclaims denying infringement, asserting patent misuse and challenging the validity of the patent. The Company filed a reply responding to such counterclaims on August 2, 2005. A Markman Hearing, to construe the individual terms of the asserted patent's claims prior to a determination of infringement, was held in October 2005. An order construing certain terms of the asserted claims was issued in January 2006. The parties are conducting fact discovery with a trial date set for November 2006. Dealix Corporation also seeks attorney's fees and costs. The Company expects to incur attorneys' fees and costs in this matter as are customary in the prosecution of patent litigation, and could be liable for Dealix Corporation's attorneys' fees and costs if Dealix Corporation is successful in its counterclaims.

Between October and December 2004, five separate purported class actions were filed in the United States District Court for the Central District of California against Autobytel and certain of its current and former directors and former officers. The claims were brought on behalf of stockholders who purchased shares during the period July 24, 2003 through October 21, 2004. The claims alleged in all of these purported class actions were virtually identical, and purported to allege violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In this regard, the plaintiffs alleged that the Company misrepresented and omitted material facts with respect to its financial results and operations during the time period between July 24, 2003 and October 20, 2004. The complaint sought unspecified compensatory damages, and attorneys' fees and costs, as well as accountants' and experts' fees. On January 28, 2005, the court ordered the consolidation of the currently pending class actions into a single case pursuant to a stipulation for consolidation signed by all parties. On March 14, 2005, the court appointed a lead plaintiff and approved the selection of lead counsel and liaison counsel. On June 30, 2005, the lead plaintiff filed and served a Consolidated Amended Class Action Complaint. The putative class period is July 24, 2003 to October 21, 2004. Defendants filed and served a motion to dismiss the Consolidated Amended Class Action Complaint on August 1, 2005 and filed their reply brief on February 17, 2006. The hearing was set for March 13, 2006, but the parties filed a stipulation to take the hearing off calendar without prejudice to re-noticing the hearing in the future. On July 31, 2006, the parties entered into a Stipulation of Settlement which was subsequently filed with the court for approval. Among the terms of the proposed settlement, the Company and individual defendants, as well as other released persons, will be released from all claims related to this action, and a settlement fund will be established. The settlement fund is expected to be funded in full by the Company's insurer. If the court does not approve the settlement or the settlement is not finalized for any other reason and the litigation continues, the Company intends to vigorously defend the claims. The Company cannot currently predict the impact or outcome of the litigation, which could have a material impact on the Company's results of operations, financial condition and cash flows. The Company has not recorded a liability against this claim as of June 30, 2006.

In addition, certain current and former directors and certain former officers of the Company are defendants in a derivative suit pending in the Superior Court of Orange County, California, and Autobytel is named as a nominal defendant in this suit. This suit purports to allege that the defendants breached numerous duties to the Company, including breach of fiduciary duty and misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment, as well as violations of California Corporations Code 25402 (trading with material non-public information), and that these breaches and violations caused losses to the Company, including damages to its reputation and goodwill. Plaintiffs' claims are based on allegations that the defendants disseminated false and misleading statements concerning the Company's results of operations and that these results were inflated at all relevant times due to violations of generally accepted accounting principles and Securities and Exchange Commission rules. The complaint seeks unspecified compensatory damages, treble damages, equitable and/or injunctive relief, restitution, and attorneys' fees and costs, as well as accountants' and experts' fees. Plaintiffs filed and served an Amended Derivative Complaint on July 29, 2005. Defendants filed and served a motion to stay and a demurrer in October 2005. On November 29, 2005, the court granted the motion to stay and set a status

conference for March 1, 2006. On February 22, 2006, the parties stipulated to continue the March 1, 2006 status conference, and the court approved the stipulation. The parties have stipulated to further continue the status conference. The Company intends to defend this suit vigorously. However, the Company cannot currently predict the impact or outcome of the litigation, which could be material, and the continuation and outcome of this lawsuit, as well as the initiation of similar suits may have a material impact on the Company's results of operations, financial condition and cash flows. The Company has not recorded a liability against this claim as of June 30, 2006.

On October 21, 2005, Autobytel received a complaint as well as a demand for arbitration/statement of claim filed by certain former shareholders of Stoneage Corporation ("Stoneage"). The complaint was filed in the Central District of California and names Autobytel as well as certain current and former officers and directors as defendants. The demand for arbitration was filed with the American Arbitration Association and names the same group of defendants. The allegations and claims in both of these matters are virtually identical and stem from the acquisition of Stoneage by Autobytel on April 15, 2004. Both the complaint and demand for arbitration contain causes of action for: breach of the acquisition agreement, breach of the registration rights agreement, violations of California Corporations Code Sections 25401 and 25501, violations of California Corporations Code Sections 25400 and 25500, fraud, negligent misrepresentation, fraudulent concealment, and violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The demand for arbitration also contains a cause of action for violation of Section 17(a) of the Securities Act of 1933. The complaint and demand for arbitration seek unspecified damages and attorneys' fees and costs, as well as rescission and punitive awards. The defendants have not responded to either the complaint or demand for arbitration. On November 29, 2005, the parties requested that the arbitration be stayed, and on February 8, 2006, the plaintiffs dismissed the complaint without prejudice. If the arbitration stay is lifted or a new complaint is filed, the Company will defend these claims vigorously. The Company cannot currently predict the outcome of this litigation, which, depending on the outcome, may have a material impact on its results of operations, financial condition or cash flows. The Company has not recorded a liability against this claim as of June 30, 2006.

From time to time, the Company is involved in other litigation matters arising from the normal course of its business activities. The actions filed against the Company 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 the Company's business, results of operations, financial condition and cash flows.

Guarantees

The Company guarantees operating lease commitments related to facilities in Westerville, Ohio and Troy, Michigan for some of its wholly-owned subsidiaries. The maximum guarantee amount is approximately $1,080,000 which represents the remaining commitment on such operating lease arrangements as of June 30, 2006.

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

The Securities and Exchange Commission ("SEC") encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This Quarterly Report on Form 10-Q contains such forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "anticipate," "estimate," "expects," "projects," "intends," "plans," "believes" and words of similar substance used in connection with any discussion of future operations or financial performance identify forward-looking statements. In particular, statements regarding expectations and opportunities, new product expectations and capabilities, and our outlook regarding our performance and growth are forward-looking statements. This Quarterly Report on Form 10-Q also contains statements regarding plans, goals and objectives. There is no assurance that we will be able to carry out such plans or achieve such goals and objectives or that we will be able to successfully do so on a profitable basis. These forward-looking statements are just predictions and involve risks and uncertainties such that actual results may differ materially from these statements. Important factors that could cause actual results to differ materially from those reflected in forward-looking statements made in this Quarterly Report on Form 10-Q are set forth under Part II "Item 1A. Risk Factors." Investors are urged not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We are under no obligation, and expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. All forward-looking statements contained herein are qualified in their entirety by the foregoing cautionary statements. Unless specified otherwise, as used herein, the terms "we," "us" or "our" refer to Autobytel Inc. and its subsidiaries.

You should read the following discussion of our results of operations and financial condition in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

Overview

We are an automotive marketing services company that helps dealers sell cars and manufacturers build brands through efficient marketing and advertising primarily through the Internet. We own and operate automotive Web sites, including Autobytel.com, Autoweb.com, Car.com, CarSmart.com, AutoSite.com, AICAutoSite.com, Autoahorros.com, and CarTV.com. We are also a leading provider of customer relationship management (CRM) products and programs, consisting of lead management products, customer loyalty and retention marketing programs, data extraction services and automotive marketing data and technology services. In the second quarter of 2006 we began, and plan to continue, to implement certain strategic initiatives, including transitioning us toward a media-centric business model, focusing on providing best-of-class marketing and media services for our dealer and manufacturer customers, and capturing integration opportunities within our business.

On June 12, 2006, our Board of Directors, at the recommendation of management, approved a realignment of our workforce, which included a reduction of our workforce by approximately 10%. The realignment was effected in order to generate operational efficiencies across our product lines and to enable new investment in key growth areas. As a result, we recorded a $0.3 million charge in the second quarter of 2006, consisting of severance costs.

Effective August 9, 2006, PricewaterhouseCoopers LLP ("PwC") will cease being our independent registered public accounting firm. We expect to select an independent registered public accounting firm to replace PwC in the third quarter of 2006.

We announced on May 1, 2006 that Michael Schmidt, our Chief Financial Officer, is expected to transition from his position upon the completion of our search for a new chief financial officer.

Richard Walker resigned as Executive Vice President and Chief Operating Officer and all other officer titles he holds with us or any of our subsidiaries effective May 31, 2006.

Our results of operations have been affected in the second quarter of 2006, and may continue to be affected in the future, by various factors, including, but not limited to, the following:

- general economic and market conditions in the automotive industry;
- the effects of competition (e.g., the availability and pricing of competing services and products and the resulting effects on sales and pricing of our services and products);
- variations in spending by automotive manufacturers on our advertising services;

- increase spending with third parties who direct search queries to our Web sites;
- stock compensation expense as a result of adopting the provisions of SFAS No. 123(R);
- costs associated with enforcing our intellectual property rights; and
- costs associated with defending purported class action, derivative and other lawsuits filed against us and certain current and former directors and officers relating to the restatements of our consolidated financial statements.

Also, our results of operations may be affected in the future by the implementation of certain strategic initiatives, including those described above. We anticipate these strategic initiatives will require an investment of approximately $3 million to $4 million in operating expenses and approximately $3 million to $4 million in capital expenditures over the remainder of 2006. There will also be further investments over the course of 2007.

For the year ending December 31, 2006, we expect that revenue from leads and advertising will both decline when compared to the same period in 2005. CRM revenues are expected to increase in 2006 when compared to 2005. Cost of revenue is expected to increase as a percentage of total revenue for the year ending December 31, 2006 when compared to the same period in 2005. Operating expenses, excluding cost of revenue, are expected to increase in 2006 when compared to 2005. Operating expenses include the previously mentioned costs associated with the implementation of our strategic initiatives, stock-based compensation expense due to the implementation of FAS 123(R) and costs associated with enforcing our intellectual property rights.

On January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), “Share-Based Payments,” which is a revision to SFAS No. 123, “Accounting for Stock-Based Compensation” issued in 1995 using the modified prospective application method. Under this transition method, compensation cost of $1.2 million was recognized in the second quarter of 2006, which includes the applicable amounts of: (a) compensation cost of all stock-based payments granted prior to, but not yet vested as of December 31, 2005 (based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123 and previously presented in the pro forma footnote disclosures), and (b) compensation cost for all stock-based payments granted subsequent to December 31, 2005 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123(R)). See Note 4, Stock-Based Compensation, in the accompanying notes to the condensed consolidated financial statements.

As of June 30, 2006, we had $38.1 million in domestic cash, cash equivalents, and short-term investments.

Net cash used in operations was $5.2 million in the second quarter of 2006. For the remainder of 2006, we expect to continue to use cash in excess of cash generated from operations.

Our lead referral dealer relationships represent domestic and imported makes of vehicles and light trucks sold in the United States. As of June 30, 2006, our lead referral dealer relationships, excluding dealer enterprise relationships attributable to automotive manufacturers or their automotive buying service affiliates, totaled approximately 6,330, encompassing approximately 5,570 retail dealer relationships (including approximately 140 suspended dealers) and relationships with major dealer groups representing approximately 760 enterprise dealer relationships. Additionally, our lead referral dealer relationships include 10 direct relationships encompassing 20 brands with automotive manufacturers or their automotive buying service affiliates through our enterprise sales initiatives representing up to approximately 21,350 enterprise dealer relationships. As of June 30, 2006, approximately 660 retail dealers had more than one retail lead referral dealer relationship with us.

A majority of our revenue from lead referral dealer relationships is derived from retail dealer relationships and enterprise dealer relationships with major dealer groups. In addition, as of June 30, 2006, our finance lead referral network included approximately 370 relationships with retail dealers, finance request intermediaries, and automotive finance companies who participate in our Car.com finance referral network. Participants in the finance referral network receive requests to arrange for financing the purchase of an automobile. As of June 30, 2006, the CRM customer relationships consisted of approximately 2,940 Web Control ®, our lead management product (“Web Control”), and approximately 900 RPM ®, our customer loyalty and retention marketing program, relationships.

As an example of how we calculate these relationships, a dealer that subscribes to the Autobytel.com new car program and the Autoweb.com new car program accounts for two retail dealer relationships, and a dealer that subscribes to our Web Control product and RPM program accounts for two CRM customer relationships. As a further example, a dealer group that owns three different franchises and that subscribes to the Autoweb.com new car program for all such franchises accounts for three retail dealer relationships. Web Control customer relationships are accounted for based on the number of customers using Web Control, rather than the number of franchises owned by a given customer. We no longer include iManager ® (our

legacy lead management tool) product relationships within CRM customer relationships, as we are offering dealers who use iManager the opportunity to migrate to our Web Control product.

Suspended dealer relationships are relationships with dealers to whom the delivery of purchase requests or performance of services has been suspended. The suspension may be initiated by us or the dealers for various reasons, including, but not limited to nonpayment by dealers or dealers temporarily not having an Internet manager. The number of dealer relationships and customer relationships as of June 30, 2006 referred to above was determined in conformity with the methodology described above.

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

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

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

Generally, our dealer contracts are terminable on 30 days' notice by either party. As of June 30, 2006, a major manufacturer in our program accounted for up to approximately 8,000 enterprise dealer relationships. This program with such major manufacturer automatically extends in one-month increments until terminated by us or the manufacturer. From time to time, a major dealer group or automotive manufacturer may significantly increase or decrease the number of enterprise dealers participating in our dealer networks or the number of purchase requests accepted from us.

Revenues from lead fees were $17.8 million and $19.7 million, or 60% and 63% of total revenues in the second quarter of 2006 and 2005, respectively.

We expect to derive a majority of our revenues in the foreseeable future from retail dealers, enterprise dealers and automotive manufacturers that participate in our online car buying referral networks and dealers, finance request intermediaries, and automotive finance companies that participate in our finance referral network.

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

We delivered approximately 0.8 million and 0.9 million purchase requests through our online systems to retail and enterprise dealers in the second quarter of 2006 and 2005, respectively. Of these, approximately 0.5 million and 0.6 million were delivered to retail dealers in the second quarter of 2006 and 2005, respectively, and approximately 0.3 million were delivered to enterprise dealers in both the second quarter of 2006 and 2005. The number of purchase requests we delivered to our retail dealers in the second quarter of 2006 reflects a decline from the same period in 2005. We are taking actions to reverse this trend. However, we cannot assure that this trend will not continue for the remainder of 2006.

Additionally, we delivered approximately 0.2 million finance requests in both the second quarter of 2006 and 2005 to retail dealers, finance request intermediaries, and automotive finance companies.

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

Revenues from advertising were $4.3 million and $4.5 million, or 15% and 14% of total revenues in the second quarter of 2006 and 2005, respectively.

CRM services consist of fees paid by customers who use our customer retention and lead management products. Customer retention and lead management products consist of Web Control, our customer lead management product, RPM, and Automotive Download Services ("ADS"), our data extraction service. Customers using our CRM services pay transaction fees based on the specified service, or ongoing monthly subscription fees based on the level of functionality selected from our suite of lead management products. Revenues from CRM services were $6.3 million and $6.0 million, or 22% and 19% of total revenues in the second quarter of 2006 and 2005, respectively.

Revenues from data, applications and other include fees from automotive marketing data and technology, classified listings for used cars, international licensing agreements, internet sales training and other products and services. Revenues from data, applications and other were $1.0 million and $1.1 million, or 3% and 4% of total revenues in the second quarter of 2006 and 2005, respectively. We develop data for use on our Web sites, and also make it available to third parties, such as automotive manufacturers and internet portals.

We continue to focus our efforts on offering marketing services to dealers and automotive manufacturers.

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

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

- termination by the dealer due to issues with purchase request volume, purchase request quality, fee increases or lack of dedicated personnel to manage the program effectively,
- termination by us due to the dealer providing poor customer service to consumers or for nonpayment of fees by the dealer,
- termination by us of dealers that cannot provide us with a reasonable profit,
- elimination of the manufacturer brand, or
- sale or termination of the dealer franchise.

From time to time as we sign major dealer groups to receive purchase requests, dealers that are part of such groups and previously represented retail dealer relationships are counted as enterprise dealer relationships. In the second quarter of 2006, we had a slight increase in our number of retail dealer relationships. We cannot assure that we will be able to continue to increase or maintain our number of retail dealer relationships. If we are unable to maintain our number of retail dealer relationships, our business, results of operations and financial condition could be materially and adversely affected.

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

Critical Accounting Policies

Stock Based Compensation Expense. Effective January 1, 2006, we adopted SFAS No. 123(R) using the modified prospective method and therefore have not restated prior periods' results. Under the fair value recognition provisions of SFAS No. 123R, we recognize stock-based compensation net of an estimated forfeiture rate and therefore only recognize compensation cost for those shares expected to vest over the service period of the award. Prior to SFAS No. 123(R) adoption, we accounted for share-based payments under APB Opinion No. 25 and, accordingly, generally recognized no

compensation expense related to share-based awards as awards were generally granted at fair value at the date of grant and accounted for forfeitures as they occurred.

Calculating stock-based compensation expense requires the input of highly subjective assumptions, including the expected term of the stock-based awards, stock price volatility, and pre-vesting option forfeitures. We estimate the expected life of options granted based on historical exercise patterns, which we believe are representative of future behavior, using a lattice expected term model. We estimate the volatility of our common stock at the date of grant based on historical volatility of our common stock for a period equal to the expected term of the awards. The assumptions used in calculating the fair value of stock-based awards represent our best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on historical experience of our stock-based awards that are granted, exercised and cancelled. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. See Note 4 — “Stock-Based Compensation” in the condensed consolidated financial statements for additional information.

Revenue Recognition. We recognize revenues when earned as defined by Staff Accounting Bulletin (“SAB”) No. 104, “Revenue Recognition,” and Emerging Issues Task Force (“EITF”) Issue 00-21, “Accounting for Revenue Arrangements with Multiple Deliverables.” SAB No. 104 considers revenue realized after all four of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the seller’s price to the buyer is fixed or determinable and (iv) collectibility is reasonably assured.

In accounting for multiple-element arrangements, one of the key judgments to be made is the accounting value that is attributable to the different contractual elements. The appropriate allocation of value not only impacts which revenue stream is credited with the revenue, it also impacts the amount and timing of revenue recorded in the consolidated statement of operations during a given period due to the differing methods of recognizing revenue. Revenue is allocated to each element based on the accounting determination of the relative fair value of that element to the aggregate fair value of all elements. The fair values must be reliable, verifiable and objectively determinable. When available, such determination is based principally on the pricing of similar cash arrangements with unrelated parties that are not part of a multiple-element arrangement. When sufficient evidence of the fair values of the individual elements does not exist, revenue is not allocated among them until that evidence exists. Instead, the revenue is recognized as earned using revenue recognition principles applicable to the entire arrangement as if it were a single element arrangement.

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,	
	2006	2005	2006	2005
Revenues	100%	100%	100%	100%
Costs and expenses:				
Cost of revenues	49	41	50	40
Sales and marketing	25	22	26	24
Product and technology development	21	20	20	19
General and administrative	32	27	33	26
Amortization of acquired intangible assets	1	1	1	1
Total costs and expenses	128	111	130	110
Loss from operations	(28)	(11)	(30)	(10)
Other income	1	1	2	1
Loss before income taxes and minority interest	(27)	(10)	(28)	(9)
Provision for income taxes	—	—	—	—
Minority interest	—	—	—	—
Net loss	(27%)	(10%)	(28%)	(9%)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues:				
Lead fees	$17,759	$19,699	$35,748	$41,324
Advertising	4,311	4,497	8,090	9,258
CRM services	6,342	6,040	12,681	11,798
Data, applications and other	960	1,149	1,925	2,333
Total revenues	$29,372	$31,385	$58,444	$64,713

Three Months Ended June 30, 2006 Compared to the Three Months Ended June 30, 2005

Revenues. Our revenues decreased by $2.0 million, or 6%, to $29.4 million in the second quarter of 2006 compared to $31.4 million in the second quarter of 2005.

Lead Fees. Lead fees decreased by $1.9 million, or 10%, to $17.8 million in the second quarter of 2006 compared to $19.7 million in the second quarter of 2005. The decrease was primarily due to a decline in the (i) purchase requests delivered to our retail dealers of 0.1 million, primarily due to a lower average monthly delivery of purchase requests per dealer coupled with a decline in our retail dealer relationships and (ii) average sales price per retail lead.

Advertising. Advertising revenue decreased by $0.2 million, or 4%, to $4.3 million in the second quarter of 2006 compared to $4.5 million in the second quarter of 2005. The decrease in advertising revenue was primarily due to lower spending by automotive manufacturers with our properties.

CRM Services. CRM services increased by $0.3 million, or 5%, to $6.3 million in the second quarter of 2006 compared to $6.0 million in the second quarter of 2005. The increase was due to an increase in fees from Web Control products as a result of an increase in the average fee per customer coupled with an increase in the number of customers from approximately 2,900 at June 30, 2005 to approximately 2,940 at June 30, 2006.

Data, Applications and Other. Revenues from data, applications and other decreased by $0.2 million or 16%, to $1.0 million in the second quarter of 2006 compared to $1.1 million in the second quarter of 2005. The decrease was primarily due to a decrease in fees from classified advertising that was discontinued in the second quarter of 2005 and international license fees as a result of the substantially complete liquidation of Autobytel.Europe in the fourth quarter of 2005, coupled with a decline in fees from training.

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

Cost of revenues increased by $1.7 million or 14% to $14.4 million in the second quarter of 2006 compared to $12.7 million in the second quarter of 2005. This represents 49% and 41% of total revenues for the second quarter of 2006 and 2005, respectively. The increase was primarily due to a $1.8 million increase in TAC as a result of our increased spending with third parties who direct search queries to our Web sites and an increase in the costs of finance requests acquired from third parties, partially offset by a decrease in the number of purchase requests acquired directly from third parties. This increase was offset by a $0.1 million decline in other costs.

Sales and Marketing. Sales and marketing expense includes costs for developing our brand equity and personnel and other costs associated with dealer sales, CRM sales, Web site advertising sales, and dealer training and support. Sales and marketing expense increased by $0.3 million, or 4%, to $7.3 million in the second quarter of 2006 compared to $7.0 million in the second quarter of 2005. This represents 25% and 22% of total revenues for the second quarter of 2006 and 2005, respectively. The increase was primarily due to a $0.3 million increase in stock compensation expense as a result of adopting the provisions of SFAS No. 123(R) on January 1, 2006.

Product and Technology Development. Product and technology development expense includes personnel costs related to developing new products, enhancing the features, content and functionality of our Web sites and our Internet-based

communications platform, costs associated with our telecommunications and computer infrastructure, and costs related to data and technology development. Product and technology development expense decreased by $0.1 million, or 2%, to $6.2 million in the second quarter of 2006 compared to $6.3 million in the second quarter of 2005. This represents 21% and 20% of total revenues for the second quarter of 2006 and 2005, respectively. The decrease was primarily due to lower personnel and related costs of $0.6 million associated with the decrease in headcount, offset by a $0.3 million charge associated with the write-off of a capitalized internal use software no longer being developed or expected to be placed in service for its intended use, and a $0.2 million increase in stock compensation expense as a result of adopting the provisions of SFAS No. 123(R) on January 1, 2006.

General and Administrative. General and administrative expense consists of executive, financial and legal personnel expenses and costs related to being a public company. General and administrative expense increased by $0.9 million, or 11%, to $9.5 million in the second quarter of 2006 compared to $8.5 million in the second quarter of 2005. This represents 32% and 27% of total revenues for the second quarter of 2006 and 2005, respectively. The increase was primarily due to:

- increase in legal fees of $2.6 million associated with enforcing our intellectual property rights,
- increase in stock compensation expense of $0.7 million as a result of adopting the provisions of SFAS No. 123(R) on January 1, 2006,
- increase in compensation costs of $0.6 million primarily associated with the separation of an officer from us and the realignment and reduction of our workforce.

These increases were offset by a:

- decrease in costs associated with the preparation and audits of our consolidated financial statements of $2.1 million, which were primarily due to professional fees incurred in the second quarter of 2005 associated with the internal review and restatements of our consolidated financial statements,
- reimbursement of $0.4 million by our insurance carrier for specific legal costs incurred associated with defending purported class and derivative action lawsuits, acquisition arbitrations litigation and securities litigation,
- decrease in other legal costs of $0.2 million, and
- decrease in other costs of $0.3 million, including recruiting and consulting fees.

Interest Income. In the second quarter of 2006, interest income increased by $0.1 million, to $0.5 million compared to $0.4 million in the second quarter of 2005. The increase in interest income was due to the investment of our cash in accounts yielding higher interest rates.

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

Income Taxes. We recorded zero for the provision for state income taxes for the second quarter of 2006 compared to $0.1 million for the second quarter of 2005.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Revenues. Our revenues decreased by $6.3 million, or 10%, to $58.4 million for the six months ended June 30, 2006 compared to $64.7 million for the same period in 2005.

Lead Fees. Lead fees decreased by $5.6 million, or 13%, to $35.7 million for the six months ended June 30, 2006 compared to $41.3 million for the same period in 2005. The increase was primarily due to a decline in the (i) purchase requests delivered to our retail dealers of 0.2 million, primarily due to a lower average monthly delivery of purchase requests per dealer coupled with a decline in our retail dealer relationships and (ii) average sales price per retail lead.

Advertising. Advertising revenue decreased by $1.2 million, or 13%, to $8.1 million for the six months ended June 30, 2006 compared to $9.3 million for the same period in 2005. The decrease was primarily due to lower spending by automotive manufacturers with our properties.

CRM Services. CRM services increased by $0.9 million, or 7%, to $12.7 million for the six months ended June 30, 2006 compared to $11.8 million for the same period in 2005. The increase was due to a $0.8 million increase in fees from Web Control products as a result of an increase in the average fee per customer coupled with an increase in the number of customers from approximately 2,900 at June 30, 2005 to approximately 2,940 at June 30, 2006 and a $0.1 million increase in RPM revenue.

Data, Applications and Other. Revenues from data, applications and other decreased by $0.4 million, or 17%, to $1.9 million for the six months ended June 30, 2006 compared to $2.3 million for the same period in 2005. The decrease was primarily due to a $0.2 million decrease in fees from classified advertising that was discontinued in the second quarter of 2005, a $0.1 million decrease in international licensing fees as a result of the substantially complete liquidation of Autobytel.Europe in the fourth quarter of 2005 and a $0.1 million decline in fees from training.

Cost of Revenues. Cost of revenues increased by $3.1 million or 12% to $29.2 million for the six months ended June 30, 2006 compared to $26.1 million for the same period in 2005. This represents 50% and 40% of total revenues for the six months ended June 30, 2006 and 2005, respectively. The increase was primarily due to a $2.7 million increase in TAC and a $0.7 million increase in printing, production and postage costs. The increase was offset by a $0.3 million decrease in amortization of capitalized internal use software and acquired intangible assets. The increase in TAC was primarily due to our increased spending with third parties who direct search queries to our Web sites and an increase in the costs of finance requests acquired from third parties, partially offset by a decrease in the number of purchase requests acquired directly from third parties. The increase in printing, production and postage costs was primarily due to the increase in customer loyalty and retention program volume in our RPM business. The decrease in amortization of capitalized internal use software and acquired intangible assets was due to certain costs that were fully amortized in 2005.

Sales and Marketing. Sales and marketing expense decreased by $0.3 million, or 2%, to $14.8 million for the six months ended June 30, 2006 compared to $15.1 million for the same period in 2005. This represents 26% and 24% of total revenues for the six months ended June 30, 2006 and 2005, respectively. The decrease was primarily due to a $0.8 million decline in advertising spending and a $0.1 million decrease in other costs, offset by $0.6 million increase in stock compensation expense as a result of adopting the provisions of SFAS No. 123(R) on January 1, 2006.

Product and Technology Development. Product and technology development expense decreased by $0.5 million, or 4%, to $11.8 million for the six months ended June 30, 2006 compared to $12.4 million for the same period in 2005. This represents 20% and 19% of total revenues for the six months ended June 30, 2006 and 2005, respectively. The decrease was primarily due to lower personnel and related costs of $1.1 million associated with the decrease in headcount and a $0.1 million decrease in telephone costs related to our voice communications, offset by a $0.4 million increase in stock compensation expense as a result of adopting the provisions of SFAS No. 123(R) on January 1, 2006 and a $0.3 million charge associated with the write-off of a capitalized internal use software no longer being developed or expected to be placed in service for its intended use.

General and Administrative. General and administrative expense increased by $2.3 million, or 14%, to $19.2 million for the six months ended June 30, 2006 compared to $16.9 million for the same period in 2005. This represents 33% and 26% of total revenues for the six months ended June 30, 2006 and 2005, respectively. The increase was primarily due to:

- increase in legal fees of $3.3 million associated with enforcing our intellectual property rights,
- increase in stock compensation expense of $1.4 million as a result of adopting the provisions of SFAS No. 123(R) on January 1, 2006,
- increase in compensation costs of $1.2 million, which includes $0.6 million associated with the separation of two employees and an officer from us and $0.1 associated with the realignment and reduction of our workforce, and
- increase in temporary personnel costs of $0.7 million.

These increases were offset by a:

- decrease in costs associated with the preparation and audits of our consolidated financial statements of $3.8 million, which were primarily due to professional fees incurred during the first six months of 2005 associated with the internal review and restatements of our consolidated financial statements,
- reimbursement of $0.4 million by our insurance carrier for specific legal costs incurred associated with defending purported class and derivative action lawsuits, acquisition arbitrations litigation and securities litigation, and
- decrease in other costs of $0.1 million.

Interest Income. For the six months ended June 30, 2006, interest income increased by $0.2 million, to $0.9 million compared to $0.7 million for the same period in 2005. The increase in interest income was due to the investment of our cash in accounts yielding higher interest rates.

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

Income Taxes. We recorded zero for the provision for state income taxes for the six months ended June 30, 2006 compared to $0.3 million for the same period in 2005.

Stock Options Granted in 2006

From January 1, 2006 through June 30, 2006, we granted (i) stock options to purchase 590,500 shares of common stock under our 1996 Stock Incentive Plan, 1998 Stock Option Plan, 1999 Stock Option Plan, 1999 Employee and Acquisition Related Stock Option Plan, 2004 Restricted Stock and Option Plan, and 2006 Inducement Stock Option Plan and (ii) an inducement stock option to purchase 1,000,000 shares of common stock to Mr. Riesenbach. The stock options were granted at our common stock closing price on the date of grant. Of the 1,000,000 inducement stock options granted to Mr. Riesenbach, 400,000 performance-based options were granted with the performance criteria to be defined at a later date. These 400,000 options are not reflected in outstanding stock options at June 30, 2006. As of June 30, 2006, excluding these 400,000 options, we had 9,081,186 outstanding stock options.

Employees

As of July 31, 2006, we had a total of 397 employees. We also utilize independent contractors as required. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our employee relations to be good.

Liquidity and Capital Resources

Our working capital decreased by $9.4 million, to $39.1 million at June 30, 2006 compared to $48.4 million at December 31, 2005. The decrease was primarily related to cash used by operations and purchases of property and equipment, offset in part by cash proceeds received from the maturity of long-term investments and the issuances of common stock in connection with the exercise of employee stock options and pursuant to our employee stock purchase plan.

Our domestic cash, cash equivalents and short-term investments totaled $38.1 million as of June 30, 2006 compared to domestic cash, cash equivalents, short-term and long-term investments of $48.4 million as of December 31, 2005. As of June 30, 2006, we had $29.2 million in domestic cash and cash equivalents and $9.0 million in short-term investments.

Net Cash Used In Operating Activities

Net cash used in operating activities was $9.5 million and $6.4 million for the six months ended June 30, 2006 and 2005, respectively. Net cash used in operating activities for the six months ended June 30, 2006 resulted primarily from the net loss of $16.3 million for the period, which was partially offset by a $0.9 million increase in accounts payable and accrued expenses, a $0.3 million increase in deferred revenues, and non-cash charges. The increase in accounts payable and accrued expenses was primarily due to professional fees incurred related to enforcing our intellectual property rights, offset in part by payments of accrued compensation costs in the first half of 2006. The increase in deferred revenues was primarily due to the deferral of revenue related to the two multiple-element arrangements mentioned above.

Net cash used in operating activities for the six months ended June 30, 2005 resulted from a net loss of $6.1 million for the period, a $3.1 million increase in accounts receivable, $0.7 million increase in prepaid expenses and other current assets and a $0.5 million decrease in accounts payable and accrued expenses, which were partially offset by non-cash charges. The $3.1 million increase in accounts receivable was primarily due to the increase in days sales outstanding from 51 days during the three months ended December 31, 2004 to 57 days for the six months ended June 30, 2005. The $0.7 million increase in prepaid expenses and other current assets was primarily due to the payment of insurance premiums during the first half of 2005, offset by the amortization of the insurance premiums. The $0.5 million decrease in accounts payable and accrued expenses was primarily due to payout of accrued compensation costs in the first half of 2005, offset by professional fees incurred related to the restatements of our consolidated financial statements, internal review, and defending purported class action and derivative lawsuits filed against us and certain current directors and current and former officers.

Net Cash Provided By Investing Activities

Net cash provided by investing activities was $4.7 million and $9.2 million for the six months ended June 30, 2006 and 2005, respectively. Cash provided by investing activities for the six months ended June 30, 2006 was related to the maturity of investments in government sponsored agency bonds, offset by purchases of short-term investment in commercial paper and purchases of property and equipment. Cash provided by investing activities for the six months ended June 30, 2005 was related to the sale and maturities of short-term investments in government sponsored agency bonds and auction rate securities, offset by purchases of short-term and long-term investments in government sponsored agency bonds and auction rate securities and purchases of property and equipment.

Net Cash Provided By Financing Activities

Net cash provided by financing activities was $0.7 million for the six months ended June 30, 2006 and nominal for the six months ended June 30, 2005. Cash provided by financing activities for the six months ended June 30, 2006 and 2005 was due to proceeds received from the sale of common stock through our employee stock purchase plan and the exercise of stock options.

Prospective Capital Needs

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 could have a material impact on our business, results of operations or financial condition.

We do not have debt. Although 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. Should we need financing, there can be no assurance that any such commitments can be obtained on favorable terms, if at all.

Although we believe that we have sufficient capital to fund our activities for at least the next 12 months, our future capital requirements may vary materially from those now planned. We anticipate that the amount of capital we will need in the future will depend on many factors, including but not limited to:

- the level of expenditures required to implement certain strategic initiatives;
- planned future growth, hiring, infrastructure and facility needs;
- changes in our compensation policies;
- the level of exercises of stock options and stock purchases under our employee stock purchase plan;
- our competitors' responses to our products and services;
- our relationships with suppliers and customers;
- the level of expenditures on marketing and advertising, including the cost of contractual arrangements with Internet portals, online information providers and other referral sources;
- the level of expenditures on product and technology development;
- the level of expenditures for general and administrative matters, including compliance with the Sarbanes-Oxley Act of 2002;
- costs associated with remediation of material weaknesses;
- the ability to increase the volume of purchase requests and finance requests and transactions related to our Web sites;
- the amount and timing of cash collection and disbursements;
- the cash portion of acquisition transactions and joint ventures; and
- costs of ongoing litigation and any adverse judgments resulting from such litigation.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined in Regulation S-K Item 303(a)(4)(ii).

Recent Accounting Pronouncements

In May 2005, FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle. It also requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We adopted SFAS No. 154 on January 1, 2006, and its adoption did not have a material effect on our consolidated financial position or results of operations.

In July 2006, FASB issued FIN 48 “Accounting for Uncertainty in Income Taxes” which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. It also provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for us beginning January 1, 2007. We are currently evaluating the impact of adopting FIN 48 on our consolidated financial statements.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

We are exposed to the impact of changes in the market values of our investments.

Investment Risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of securities, including both government and corporate obligations and money market funds. For the three months and six months ended June 30, 2006 and 2005, net unrealized losses on these investments were not material.

Investments in both fixed-rate and floating-rate interest-earning instruments carry varying degrees of interest rate risk. The fair market value of our fixed-rate securities may be adversely impacted due to a rise in interest rates. In general, securities with longer maturities are subject to greater interest-rate risk than those with shorter maturities. While floating rate securities generally are subject to less interest-rate risk than fixed-rate securities, floating-rate securities may produce less income than expected if interest rates decrease. Due in part to these factors, our investment income may fall short of expectations. If interest rates were to increase (decrease) by 100 basis points, the fair market value of our total investment portfolio could decrease (increase) on an annual basis by approximately $0.4 million.

Item 4. *Controls and Procedures*

As described more fully in our Management’s Report On Internal Control Over Financial Reporting set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2005, and this assessment identified internal control deficiencies that individually or collectively constitute material weaknesses in our internal control over financial reporting. Management currently is implementing certain remedial measures identified in Part II “Item 9A Controls and Procedures” of our Annual Report on Form 10-K for the year ended December 31, 2005, and intends to implement the remaining remedial measures during the course of 2006. While this implementation is underway, we are relying on extensive manual procedures and the utilization of outside accounting professionals to assist us with meeting the objectives otherwise fulfilled by an effective control environment. While we are implementing changes to our control environment, there remains a risk that the transitional procedures on which we are currently relying will fail to be sufficiently effective to address the internal control deficiencies identified in Management’s Report On Internal Control Over Financial Reporting. Please see Part II “Item 1A. “Risk Factors—Our internal controls and procedures need to be improved.”

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Because of the internal control deficiencies included in Management’s Report On Internal Control Over Financial Reporting, our Chief Executive Officer and our Chief Financial Officer believe that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were not effective at ensuring that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms or (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required financial disclosure. Notwithstanding the material weaknesses, our management concluded that the financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with generally accepted accounting principles.

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In August 2001, a purported class action lawsuit was filed in the United States District Court for the Southern District of New York against Autobytel and certain of the Company's current and former directors and officers (the "Autobytel Individual Defendants") and underwriters involved in the Company's initial public offering. The complaints against the Company 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 the Company'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 the Company'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 the Company. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Underwriter Defendants sought leave to appeal this decision and the Second Circuit has accepted the appeal. Plaintiffs have not yet moved to certify a class in the Company case. The Company has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autobytel, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of the Company and the Autobytel Individual Defendants for the conduct alleged in the action to be wrongful. The Company would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. The settlement agreement also provides a guaranteed recovery of one billion dollars to plaintiffs for the cases relating to all of the approximately 300 issuers. On April 20, 2006, JPMorgan Chase and the plaintiffs reached a preliminary agreement for a settlement for $425 million. The JPMorgan Chase settlement has not yet been approved by the Court. However, if it is finally approved, then the maximum amount that the issuers' insurers will be potentially liable for is $575 million. To the extent that the underwriter defendants settle all of the cases for at least one billion dollars, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of the Company to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. The Company currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and the Company is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, the Company does not expect that the settlement will involve any payment by the Company. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from the Company's insurance carriers should arise, the Company's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. However, if the JPMorgan Chase settlement is finally approved, the Company's maximum financial obligation to the plaintiffs pursuant to the settlement agreement would be less than $2 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. On March 20, 2006, the Underwriter Defendants submitted objections to the settlement to the Court. The Court held a hearing regarding these and any other objections to the settlement at a fairness hearing on April 24, 2006, but it has not yet issued a ruling. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and the Company is found liable, the Company is unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than its insurance coverage, or whether such damages would have a material impact on its results of operations, financial condition or cash flows in any future period.

Between April and June 2001, eight separate purported class actions virtually identical to the one filed against Autobytel were filed against Autoweb.com, Inc. ("Autoweb"), certain of Autoweb's former directors and officers (the "Autoweb Individual Defendants") and underwriters involved in Autoweb's initial public offering. The complaints against Autoweb have been consolidated into a single action, and a Consolidated Amended Complaint, which is now the operative complaint, was filed on April 19, 2002. The foregoing action purports to allege violations of the Securities Act of 1933 and

the Securities Exchange Act of 1934. Plaintiffs allege that the underwriter defendants agreed to allocate stock in Autoweb's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for Autoweb's initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The action seeks damages in an unspecified amount. The action is being coordinated with approximately 300 other nearly identical actions filed against other companies. A motion to dismiss addressing issues common to the companies and individuals who have been sued in these actions was filed on July 15, 2002. On October 9, 2002, the Court dismissed the Autoweb Individual Defendants from the case without prejudice based upon Stipulations of Dismissal filed by the plaintiffs and the Autoweb Individual Defendants. On February 19, 2003, the Court dismissed the Section 10(b) claim without prejudice and with leave to replead but denied the motion to dismiss the claim under Section 11 of the Securities Act of 1933 against Autoweb. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Underwriter Defendants sought leave to appeal this decision and the Second Circuit has accepted the appeal. Plaintiffs have not yet moved to certify a class in the Autoweb case. Autoweb has approved a settlement agreement and related agreements which set forth the terms of a settlement between Autoweb, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of Autoweb and the Autoweb Individual Defendants for the conduct alleged in the action to be wrongful. Autoweb would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims Autoweb may have against its underwriters. The settlement agreement also provides a guaranteed recovery of one billion dollars to plaintiffs for the cases relating to all of the approximately 300 issuers. On April 20, 2006, JPMorgan Chase and the plaintiffs reached a preliminary agreement for a settlement for $425 million. The JPMorgan Chase settlement has not yet been approved by the Court. However, if it is finally approved, then the maximum amount that the issuers' insurers will be potentially liable for is $575 million. To the extent that the underwriter defendants settle all of the cases for at least one billion dollars, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. It is anticipated that any potential financial obligation of Autoweb to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be directly covered and paid by its insurance carriers. Autoweb currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and Autoweb is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, the Company does not expect that the settlement will involve any payment by Autoweb. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from Autoweb's insurance carriers should arise, Autoweb's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. However, if the JPMorgan Chase settlement is finally approved, the Company's maximum financial obligation to the plaintiffs pursuant to the settlement agreement would be less than $2 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. On March 20, 2006, the Underwriter Defendants submitted objections to the settlement to the Court. The Court held a hearing regarding these and any other objections to the settlement at a fairness hearing on April 24, 2006, but it has not yet issued a ruling. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and Autoweb is found liable, the Company is unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than Autoweb's insurance coverage, or whether such damages would have a material impact on the Company's results of operations, financial condition or cash flows in any future period.

The Company has reviewed the above class action matters and does not believe that it is probable that a loss contingency has occurred; therefore, the Company has not recorded a liability against these claims as of June 30, 2006.

On September 24, 2004, the Company filed a lawsuit in the United States District Court for the Eastern District of Texas against Dealix Corporation. In that lawsuit, the Company asserted infringement of U.S. Patent No. 6,282,517, entitled "Real Time Communication of Purchase Requests," against Dealix Corporation. The Company contended that Dealix Corporation is infringing Autobytel's patent by virtue of Dealix Corporation's software system for the distribution of purchase requests, and sought damages and/or a preliminary injunction. Dealix Corporation filed answers to this lawsuit on January 28, 2005, February 1, 2005 and July 19, 2005, in which it asserts typical defensive counterclaims denying infringement, asserting patent misuse and challenging the validity of the patent. The Company filed a reply responding to such counterclaims on August 2, 2005. A Markman Hearing, to construe the individual terms of the asserted patent's claims prior to a determination of infringement, was held in October 2005. An order construing certain terms of the asserted claims was issued in January 2006. The parties are conducting fact discovery with a trial date set for November 2006. Dealix Corporation also seeks attorney's fees and costs. The Company expects to incur attorneys' fees and costs in this matter as are

customary in the prosecution of patent litigation, and could be liable for Dealix Corporation's attorneys' fees and costs if Dealix Corporation is successful in its counterclaims.

Between October and December 2004, five separate purported class actions were filed in the United States District Court for the Central District of California against Autobytel and certain of its current and former directors and former officers. The claims were brought on behalf of stockholders who purchased shares during the period July 24, 2003 through October 21, 2004. The claims alleged in all of these purported class actions were virtually identical, and purported to allege violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In this regard, the plaintiffs alleged that the Company misrepresented and omitted material facts with respect to its financial results and operations during the time period between July 24, 2003 and October 20, 2004. The complaint sought unspecified compensatory damages, and attorneys' fees and costs, as well as accountants' and experts' fees. On January 28, 2005, the court ordered the consolidation of the currently pending class actions into a single case pursuant to a stipulation for consolidation signed by all parties. On March 14, 2005, the court appointed a lead plaintiff and approved the selection of lead counsel and liaison counsel. On June 30, 2005, the lead plaintiff filed and served a Consolidated Amended Class Action Complaint. The putative class period is July 24, 2003 to October 21, 2004. Defendants filed and served a motion to dismiss the Consolidated Amended Class Action Complaint on August 1, 2005 and filed their reply brief on February 17, 2006. The hearing was set for March 13, 2006, but the parties filed a stipulation to take the hearing off calendar without prejudice to re-noticing the hearing in the future. On July 31, 2006, the parties entered into a Stipulation of Settlement which was subsequently filed with the court for approval. Among the terms of the proposed settlement, the Company and individual defendants, as well as other released persons, will be released from all claims related to this action, and a settlement fund will be established. The settlement fund is expected to be funded in full by the Company's insurer. If the court does not approve the settlement or the settlement is not finalized for any other reason and the litigation continues, the Company intends to vigorously defend the claims. The Company cannot currently predict the impact or outcome of the litigation, which could have a material impact on the Company's results of operations, financial condition and cash flows. The Company has not recorded a liability against this claim as of June 30, 2006.

In addition, certain current and former directors and certain former officers of the Company are defendants in a derivative suit pending in the Superior Court of Orange County, California, and Autobytel is named as a nominal defendant in this suit. This suit purports to allege that the defendants breached numerous duties to the Company, including breach of fiduciary duty and misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment, as well as violations of California Corporations Code 25402 (trading with material non-public information), and that these breaches and violations caused losses to the Company, including damages to its reputation and goodwill. Plaintiffs' claims are based on allegations that the defendants disseminated false and misleading statements concerning the Company's results of operations and that these results were inflated at all relevant times due to violations of generally accepted accounting principles and SEC rules. The complaint seeks unspecified compensatory damages, treble damages, equitable and/or injunctive relief, restitution, and attorneys' fees and costs, as well as accountants' and experts' fees. Plaintiffs filed and served an Amended Derivative Complaint on July 29, 2005. Defendants filed and served a motion to stay and a demurrer in October 2005. On November 29, 2005, the court granted the motion to stay and set a status conference for March 1, 2006. On February 22, 2006, the parties stipulated to continue the March 1, 2006 status conference, and the court approved the stipulation. The parties have stipulated to further continue the status conference. The Company intends to defend this suit vigorously. However, the Company cannot currently predict the impact or outcome of the litigation, which could be material, and the continuation and outcome of this lawsuit, as well as the initiation of similar suits may have a material impact on the Company's results of operations, financial condition and cash flows. The Company has not recorded a liability against this claim as of June 30, 2006.

On October 21, 2005, Autobytel received a complaint as well as a demand for arbitration/statement of claim filed by certain former shareholders of Stoneage Corporation ("Stoneage"). The complaint was filed in the Central District of California and names Autobytel as well as certain current and former officers and directors as defendants. The demand for arbitration was filed with the American Arbitration Association and names the same group of defendants. The allegations and claims in both of these matters are virtually identical and stem from the acquisition of Stoneage by Autobytel on April 15, 2004. Both the complaint and demand for arbitration contain causes of action for: breach of the acquisition agreement, breach of the registration rights agreement, violations of California Corporations Code Sections 25401 and 25501, violations of California Corporations Code Sections 25400 and 25500, fraud, negligent misrepresentation, fraudulent concealment, and violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The demand for arbitration also contains a cause of action for violation of Section 17(a) of the Securities Act of 1933. The complaint and demand for arbitration seek unspecified damages and attorneys' fees and costs, as well as rescission and punitive awards. The defendants have not responded to either the complaint or demand for arbitration. On November 29, 2005, the parties requested that the arbitration be stayed, and on February 8, 2006, the plaintiffs dismissed the complaint

without prejudice. If the arbitration stay is lifted or a new complaint is filed, the Company will defend these claims vigorously. The Company cannot currently predict the outcome of this litigation, which, depending on the outcome, may have a material impact on its results of operations, financial condition or cash flows. The Company has not recorded a liability against this claim as of June 30, 2006.

From time to time, the Company is involved in other litigation matters arising from the normal course of its business activities. The actions filed against the Company 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 the Company's business, results of operations, financial condition and cash flows.

Item 1A. Risk Factors

In addition to the factors discussed in the "Overview" and "Liquidity and Capital Resources" sections of Part I "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report on Form 10-Q, the following additional factors may affect our future results.

We have only been profitable from the fourth quarter of 2002 through the fourth quarter of 2004 and otherwise have a history of net losses. We incurred a loss in 2005 and the first half of 2006 and cannot assure that we will be profitable in the future. If we are unable to achieve profitability in the future and we continue to 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 have long-term experience in the industry. This limited operating history contributes to our difficulty in predicting future operating results.

We have incurred losses every quarter through the third quarter of 2002 and have achieved profitability from the fourth quarter of 2002 through the fourth quarter of 2004. We incurred a loss in 2005 and the first half of 2006. We cannot assure that we will be profitable in the future. We had an accumulated deficit of $171.0 million and $154.6 million as of June 30, 2006 and December 31, 2005, respectively.

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

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

- continue to upgrade and enhance our technologies to accommodate expanded service offerings and increased consumer traffic.

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

Our internal controls and procedures need to be improved.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. In making its assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005, management used the criteria described in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). A material weakness is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Management determined that we had material weaknesses in our internal control over financial reporting as of December 31, 2005. The material weaknesses relate to not having a sufficient complement of personnel with an appropriate level of accounting knowledge, experience, and training in the application of generally accepted accounting principles commensurate with our financial reporting requirements, which contributed to material weaknesses in recording (a) revenue and deferred revenue and (b) accrued liabilities and the related expense accounts. Further, these material weaknesses resulted in an adverse opinion by our independent registered public accounting firm on the effectiveness of our internal control over financial reporting.

If we are unable to substantially improve the effectiveness of our internal control over financial reporting, our ability to report our financial results on a timely and accurate basis will continue to be adversely affected. If our financial statements are not fairly presented, investors may not have a complete understanding of our operating results and financial condition. If our financial statements are not timely filed with the SEC, we could be delisted from NASDAQ. If either or both of these events occur, it could have a material adverse affect on our ability to operate our business. Please see Part II "Item 9A. Controls and Procedures" of our Annual Report on Form 10-K for the year ended December 31, 2005 for more information regarding the measures we have commenced to implement, and which we intend to implement during the course of 2006, which are designed to remediate the material weaknesses in our internal controls described in our Management's Report On Internal Control Over Financial Reporting set forth on page 2 of our Annual Report on Form 10-K for the year ended December 31, 2005. The costs of remediating such deficiencies in our internal controls may adversely affect our financial condition and results of operations. In addition, even after the remedial measures discussed in Part II "Item 9A. Controls and Procedures" of our Annual Report on Form 10-K for the year ended December 31, 2005 are fully implemented, our internal controls may not prevent all potential error and fraud, because any control system, no matter how well designed, can only provide reasonable and not absolute assurance that the objectives of the control system will be achieved.

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

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

On January 28, 2005, the court ordered the consolidation of the currently pending class actions into a single case pursuant to a stipulation for consolidation signed by all parties. On March 14, 2005, the court appointed a lead plaintiff and approved the selection of lead counsel and liaison counsel. On June 30, 2005, the lead plaintiff filed and served a Consolidated Amended Class Action Complaint. The putative class period is July 24, 2003 to October 21, 2004. Defendants filed and served a motion to dismiss the Consolidated Amended Class Action Complaint on August 1, 2005 and filed their

reply brief on February 17, 2006. The hearing was set for March 13, 2006, but the parties filed a stipulation to take the hearing off calendar without prejudice to re-noticing the hearing in the future. On July 31, 2006, the parties entered into a Stipulation of Settlement which was subsequently filed with the court for approval. Among the terms of the proposed settlement, we and individual defendants, as well as other released persons, will be released from all claims related to this action, and a settlement fund will be established. The settlement fund is expected to be funded in full by our insurer. If the court does not approve the settlement or the settlement is not finalized for any other reason and the litigation continues, we intend to vigorously defend the claims. We cannot currently predict the impact or outcome of the litigation, which could have a material impact on our results of operations, financial condition and cash flows.

In addition, certain of our present and former directors and certain former officers are defendants in a derivative suit pending in the Superior Court of Orange County, California, and we are named as a nominal defendant in this suit. This suit purports to allege that the defendants breached numerous duties to us, including breach of fiduciary duty and misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment, as well as violations of California Corporations Code 25402 (trading with material non-public information), and that these breaches and violations caused losses to us, including damages to our reputation and goodwill. Plaintiffs' claims are based on allegations that the defendants disseminated false and misleading statements concerning our results of operations and that these results were inflated at all relevant times due to violations of generally accepted accounting principles and SEC rules. The complaint seeks unspecified compensatory damages, treble damages, equitable and/or injunctive relief, restitution, and attorneys' fees and costs, as well as accountants' and experts' fees. Plaintiffs filed and served an Amended Derivative Complaint on July 29, 2005. On November 29, 2005, the court granted the motion to stay and set a status conference for March 1, 2006. On February 22, 2006, the parties stipulated to continue the March 1, 2006 status conference, and the court approved the stipulation. Defendants filed and served a motion to stay and a demurrer in October 2005. We intend to defend this suit vigorously. However, we cannot currently predict the impact or outcome of this litigation, which could be material, and the continuation and outcome of this lawsuit, as well as the initiation of similar suits may have a material impact on our results of operations and financial condition.

On October 21, 2005, we received a complaint as well as a demand for arbitration/statement of claim filed by certain former shareholders of Stoneage Corporation ("Stoneage"). The complaint was filed in the Central District of California and names us as well as certain current and former officers and directors as defendants. The demand for arbitration was filed with the American Arbitration Association and names the same group of defendants. The allegations and claims in both of these matters are virtually identical and stem from the acquisition of Stoneage by us on April 15, 2004. Both the complaint and demand for arbitration contain causes of action for: breach of the acquisition agreement, breach of the registration rights agreement, violations of California Corporations Code Sections 25401 and 25501, violations of California Corporations Code Sections 25400 and 25500, fraud, negligent misrepresentation, fraudulent concealment, and violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The demand for arbitration also contains a cause of action for violation of Section 17(a) of the Securities Act of 1933. The complaint and demand for arbitration seek unspecified damages and attorneys' fees and costs, as well as rescission and punitive awards. The defendants have not responded to either the complaint or demand for arbitration. On November 29, 2005, the parties requested that the arbitration be stayed, and on February 8, 2006, the plaintiffs dismissed the complaint without prejudice. If the arbitration stay is lifted or a new complaint is filed, we will defend these claims vigorously. We cannot currently predict the outcome of this litigation, which, depending on the outcome, may have a material impact on our results of operations, financial condition or cash flows.

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

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

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

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

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 have and expect to continue to replace certain of our executive officers during 2006. If we are unable to recruit and integrate new executive officers to fill these positions our business, results of operations and financial condition may be materially adversely affected.

We may incur substantial expenses relating to remediation of material weaknesses in our internal controls identified by our management, which could materially and adversely affect our financial condition, results of operations, and cash flows.

We may incur substantial expenses relating to the remediation of material weaknesses in our internal controls identified by our management. These expenses could materially and adversely affect our financial condition, results of operations, and cash flows.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In the summer of 2005, some manufacturers introduced programs allowing all consumers to purchase new vehicles at prices offered to employees. Employee pricing and future actions by manufacturers that promote transparent pricing may

negatively affect the perceived value of our services to consumers and dealers. A decline in the perceived value of our services to consumers and dealers may result in a decline in demand for our services, which could adversely affect our business, financial condition and results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

We must also:

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

We cannot assure that we can successfully achieve these objectives.

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

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

such state. In each case, our revenues may decline and our business, results of operations and financial condition could be materially and adversely affected.

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

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

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

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

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

There are many risks associated with consummated and potential acquisitions.

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

Acquisitions involve numerous risks. For example:

- It may be difficult to assimilate the operations and personnel of an acquired business into our own business,
- Management information and accounting systems of an acquired business must be integrated into our current systems,
- We may lose dealers participating in both our network as well as that of the acquired business, if any,
- Our management must devote its attention to assimilating the acquired business which diverts attention from other business concerns,

- We may enter markets in which we have limited prior experience, and
- We may lose key employees of an acquired business.

Government regulations may result in increased costs that may reduce our future earnings.

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

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

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

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

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

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

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

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

With the exception of the ADS production servers and certain related systems, our production Web sites and certain systems, including Autobytel.com, Autoweb.com, CarSmart.com, AutoSite.com, Car.com, Finance.Car.com, AVV.com, iDriveonline and RPM are currently hosted at secure third-party hosting facilities. We host the ADS production servers at a company owned facility.

Although backup servers are available, our primary servers are vulnerable to interruption by damage from fire, earthquake, flood, power loss, telecommunications failure, break-ins and other events beyond our control. In the event that we experience significant system disruptions, our business, results

of operations and financial condition would be materially and adversely affected. We have, from time to time, experienced periodic systems interruptions and anticipate that such interruptions will occur in the future.

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

We maintain business interruption insurance which pays up to $9.0 million for the actual loss of business income sustained due to the suspension of operations as a result of direct physical loss of or damage to property at our offices. However, in the event of a prolonged interruption, this business interruption insurance may not be sufficient to fully compensate us for the resulting losses.

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

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

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

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

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

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

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

Prior to the initial public offering of our common stock in March 1999, there was no public market for our common stock. We cannot assure that an active trading market will be sustained or that the market price of the common stock will not

decline. The stock market in general and the shares of emerging companies in particular have experienced significant price fluctuations. The market price of our common stock is likely to continue to be highly volatile and could be subject to wide fluctuations in response to factors such as:

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

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

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

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

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

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

Our computer infrastructure is potentially vulnerable to physical or electronic computer break-ins, viruses and similar disruptive problems and security breaches. Any such problems or security breaches could cause us to have liability to one or more third parties and disrupt all or part of our operations. A party able to circumvent our security measures could misappropriate proprietary information, customer information or consumer information, jeopardize the confidential nature of information transmitted over the Internet or cause interruptions in our operations. Concerns over the security of Internet transactions and the privacy of users could also inhibit the growth of the Internet in general, particularly as a means of conducting commercial transactions. To the extent that our activities or those of third-party contractors involve the storage

and transmission of proprietary information such as personal financial information, security breaches could expose us to a risk of financial loss, litigation and other liabilities. Our current insurance program may protect us against some, but not all, of such losses. Any of these events could have a material adverse effect on our business, results of operations and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

We are a defendant in certain proceedings which are described in “Item 1. Legal Proceedings” herein.

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

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

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

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

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

of our common stock and may have the effect of delaying or preventing a change in control. The issuance of preferred stock also could decrease the amount of earnings and assets available for distribution to the holders of common stock or could adversely affect the rights and powers, including voting rights, of the holders of the common stock.

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

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

We held our Annual Meeting of Stockholders on June 12, 2006. The following is a brief description of the matter voted upon at the meeting and the number of votes cast for or withheld with respect to such matter. Each director proposed by us was elected.

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

Director	For	Withheld Authority
Mark N. Kaplan	31,638,906	3,481,965
James E. Riesenbach	34,918,370	202,501

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

Item 6. **Exhibits**

10.1	First Amendment to Employment Agreement dated as of April 26, 2006 between Autobytel Inc. and Michael Schmidt is incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 1, 2006.
10.2	2006 Inducement Stock option Plan is incorporated herein by reference to Exhibit 4.9 of the Registration Statement on Form S-8 (File No. 333-135076) filed with the Securities and Exchange Commission on June 16, 2006 (the “2006 S-8”).
10.3	Form of Employee Inducement Stock Option Agreement is incorporated herein by reference to Exhibit 4.10 of the 2006 S-8.
10.4	Inducement Stock Option Agreement dated March 20, 2006 between James E. Riesenbach and Autobytel is incorporated herein by reference to Exhibit 4.11 of the 2006 S-8.
31.1*	Chief Executive Officer Section 302 Certification of Periodic Report, dated August 9, 2006.
31.2*	Chief Financial Officer Section 302 Certification of Periodic Report, dated August 9, 2006.
32.1*	Chief Executive Officer and Chief Financial Officer Section 906 Certification of Periodic Report, dated August 9, 2006.

* Filed herewith.

Table of Contents

SIGNATURES

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

AUTOBYTEL INC.

By: /S/ MICHAEL F. SCHMIDT

Michael F. Schmidt
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial Officer)

Date: August 9, 2006

By: /s/ JILL C. RICHLING

Jill C. Richling
Vice President and Controller
(Principal Accounting Officer)

EXHIBIT INDEX

10.1	First Amendment to Employment Agreement dated as of April 26, 2006 between Autobytel Inc. and Michael Schmidt is incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 1, 2006.
10.2	2006 Inducement Stock option Plan is incorporated herein by reference to Exhibit 4.9 of the Registration Statement on Form S-8 (File No. 333-135076) filed with the Securities and Exchange Commission on June 16, 2006 (the “2006 S-8”).
10.3	Form of Employee Inducement Stock Option Agreement is incorporated herein by reference to Exhibit 4.10 of the 2006 S-8.
10.4	Inducement Stock Option Agreement dated March 20, 2006 between James E. Riesenbach and Autobytel is incorporated herein by reference to Exhibit 4.11 of the 2006 S-8.
31.1*	Chief Executive Officer Section 302 Certification of Periodic Report, dated August 9, 2006.
31.2*	Chief Financial Officer Section 302 Certification of Periodic Report, dated August 9, 2006.
32.1*	Chief Executive Officer and Chief Financial Officer Section 906 Certification of Periodic Report, dated August 9, 2006.

* Filed herewith.

Exhibit 31.1

CERTIFICATION

I, James E. Riesenbach, President and Chief Executive Officer of Autobytel Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Autobytel Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and 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) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2006

/s/ James E. Riesenbach
James E. Riesenbach
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Michael F. Schmidt, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2006

/s/ Michael F. Schmidt

Michael F. Schmidt,
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, 2006 (the " *Report* "), we, James E. Riesenbach, Chief Executive Officer of the Company, and Michael F. Schmidt, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ James E. Riesenbach
James E. Riesenbach
Chief Executive Officer
August 9, 2006

/s/ Michael F. Schmidt
Michael F. Schmidt
Executive Vice President and
Chief Financial Officer
August 9, 2006

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.