

U.S. Auto Parts Network, Inc.  
Form 10-Q  
August 10, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended July 2, 2011

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: 001-33264

**U.S. AUTO PARTS NETWORK, INC.**

(Exact name of registrant as specified in its charter)

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

**68-0623433**  
(I.R.S. Employer  
Identification No.)

**17150 South Margay Avenue**

**Carson, CA 90746**

(Address of Principal Executive Office) (Zip Code)

**(310) 735-0085**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of August 5, 2011, the registrant had 30,559,985 shares of common stock, \$0.001 par value, outstanding.

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**U.S. AUTO PARTS NETWORK, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE THIRTEEN AND TWENTY-SIX WEEKS ENDED JULY 2, 2011**

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Unless the context requires otherwise, as used in this report, the terms "U.S. Auto Parts," "the Company," "we," "us" and "our" refer to U.S. Auto Parts Network, Inc. and its subsidiaries.

U.S. Auto Parts®, U.S. Auto Parts Network, PartsTrain®, Partsbin, Kool-Vue, and Stylintruck™, amongst others, are our United States trademarks. All other trademarks and trade names appearing in this report are the property of their respective owners.

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*The statements included in this report, other than statements or characterizations of historical or current fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ), and we intend that such forward-looking statements be subject to the safe harbors created thereby. Any forward-looking statements included herein are based on management s beliefs and assumptions and on information currently available to management. We have attempted to identify forward-looking statements by terms such as anticipates, believes, could, estimates, expects, intends, may, plans, potential, predicts, projects, should, will, would , will likely continue, will likely result and similar expressions. These forward-looking statements include, but are not limited to, statements regarding future events, our future operating and financial results, financial expectations, expected growth and strategies, current business indicators, capital needs, capital deployment, liquidity, contracts, litigation, product offerings, customers, acquisitions, competition and the status of our facilities. Forward-looking statements, no matter where they occur in this document or in other statements attributable to the Company involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. We discuss many of these risks in greater detail under the heading Risk Factors in Part II, Item 1A of this report. Given these uncertainties, you should not place undue reliance on these forward-looking statements. You should read this report and the documents that we reference in this report and have filed as exhibits to the report completely and with the understanding that our actual future results may be materially different from what we expect. Also, forward-looking statements represent our management s beliefs and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.*

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****U.S. AUTO PARTS NETWORK, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share amounts and par value)

	July 2, 2011	January 1, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 16,249	\$ 17,595
Short-term investments	1,112	1,062
Accounts receivable, net of allowances of \$200 and \$372, respectively	8,839	6,849
Inventory	45,804	48,100
Deferred income taxes	360	359
Other current assets	4,448	5,646
<b>Total current assets</b>	<b>76,812</b>	<b>79,611</b>
Property and equipment, net	34,346	33,140
Intangible assets, net	15,781	18,718
Goodwill	17,344	17,137
Investments	3,766	4,141
Other non-current assets	1,073	790
<b>Total assets</b>	<b>\$ 149,122</b>	<b>\$ 153,537</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 33,014	\$ 31,660
Accrued expenses	13,741	15,487
Current portion of long-term debt	6,250	6,125
Current portion of capital leases payable	149	132
Other current liabilities	5,181	5,522
<b>Total current liabilities</b>	<b>58,335</b>	<b>58,926</b>
Long-term debt, net of current portion	14,750	17,875
Capital leases payable, net of current portion	94	185
Deferred income taxes	3,267	3,046
Other non-current liabilities	963	701
<b>Total liabilities</b>	<b>77,409</b>	<b>80,733</b>
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value; 100,000,000 shares authorized at July 2, 2011 and January 1, 2011; 30,559,985 and 30,429,376 shares issued and outstanding at July 2, 2011 and January 1, 2011, respectively	31	30
Additional paid-in capital	155,620	153,962
Accumulated other comprehensive income	309	249
Accumulated deficit	(84,247)	(81,437)

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Total stockholders' equity	71,713	72,804
Total liabilities and stockholders' equity	\$ 149,122	\$ 153,537

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents****U.S. AUTO PARTS NETWORK, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except share and per share amounts)

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Net sales	\$ 84,268	\$ 53,188	\$ 171,246	\$ 109,479
Cost of sales <sup>(1)</sup>	55,854	34,791	112,416	71,275
Gross profit	28,414	18,397	58,830	38,204
Operating expenses:				
Marketing <sup>(2)</sup>	14,366	7,138	27,951	14,351
General and administrative <sup>(2)</sup>	8,407	6,395	16,643	12,132
Fulfillment <sup>(2)</sup>	4,592	2,924	9,599	6,167
Technology <sup>(2)</sup>	1,917	1,158	3,855	2,176
Amortization of intangibles	1,363	124	2,990	245
Total operating expenses	30,645	17,739	61,038	35,071
(Loss) income from operations	(2,231)	658	(2,208)	3,133
Other income (expense):				
Other income (expense)	47	(5)	78	(4)
Interest (expense) income	(185)	34	(467)	55
Total other (expense) income, net	(138)	29	(389)	51
(Loss) income before income taxes	(2,369)	687	(2,597)	3,184
Income tax provision	195	225	213	1,175
Net (loss) income	\$ (2,564)	\$ 462	\$ (2,810)	\$ 2,009
Basic net (loss) income per share	\$ (0.08)	\$ 0.02	\$ (0.09)	\$ 0.07
Diluted net (loss) income per share	\$ (0.08)	\$ 0.01	\$ (0.09)	\$ 0.06
Shares used in computation of basic net (loss) income per share	30,543,037	30,314,478	30,496,558	30,158,797
Shares used in computation of diluted net (loss) income per share	30,543,037	31,994,447	30,496,558	31,723,316

<sup>(1)</sup> Excludes depreciation and amortization expense which is included in marketing, general and administrative and fulfillment costs.<sup>(2)</sup> Includes share-based compensation expense related to option grants, as follows:

Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended	Twenty-Six Weeks Ended
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			July 2, 2011	July 3, 2010
Marketing	\$ 88	\$ 72	\$ 248	\$ 192
General and administrative	399	452	775	1,000
Fulfillment	91	64	176	189
Technology	65	24	125	91
<b>Total share-based compensation expense</b>	<b>\$ 643</b>	<b>\$ 612</b>	<b>\$ 1,324</b>	<b>\$ 1,472</b>

See accompanying notes to unaudited condensed consolidated financial statements.



**Table of Contents****U.S. AUTO PARTS NETWORK, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	<b>Twenty-Six Weeks Ended July 2, 2011</b>	<b>Twenty-Six Weeks Ended July 3, 2010</b>
<b>Operating activities</b>		
Net (loss) income	\$ (2,810)	\$ 2,009
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	6,075	3,934
Amortization of intangibles	2,990	245
Share-based compensation	1,324	1,472
Deferred income taxes	219	790
Amortization of deferred financing costs	61	
Excess tax benefits from share-based payment arrangements		(237)
Changes in operating assets and liabilities:		
Accounts receivable	(1,990)	802
Inventory	2,296	(7,926)
Prepaid expense and other current assets	(187)	(865)
Other noncurrent assets		(81)
Accounts payable and accrued expenses	(477)	7,639
Other current liabilities	(338)	1,218
Other noncurrent liabilities	258	317
Net cash provided by operating activities	7,421	9,317
<b>Investing activities</b>		
Additions to property and equipment	(7,221)	(6,293)
Purchases of intangibles	(48)	(1,001)
Changes in restricted cash	319	
Proceeds from sale of marketable securities	400	4,236
Purchases of marketable securities	(13)	(17,984)
Purchases of company-owned life insurance	(281)	(250)
Proceeds from purchase price adjustment	787	
Net cash used in investing activities	(6,057)	(21,292)
<b>Financing activities</b>		
Payments made on long-term debt	(3,000)	
Changes in book overdraft	152	
Payments of short-term financing	(74)	
Payments of debt financing costs	(53)	
Excess tax benefits from share-based payment arrangements		237
Proceeds from exercise of stock options	255	658
Net cash (used in) provided by financing activities	(2,720)	895
Effect of exchange rate changes on cash	10	26
Net change in cash and cash equivalents	(1,346)	(11,054)
Cash and cash equivalents, beginning of period	17,595	26,251
Cash and cash equivalents, end of period	\$ 16,249	\$ 15,197

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### Supplemental disclosure of non-cash investing and financing activities:

Accrued asset purchases	\$	1,572	\$	571
Property acquired under capital lease		32		
Unrealized gain on investments		27		66

### Supplemental disclosure of cash flow information:

Cash paid during the period for income taxes	\$	9	\$	87
Cash paid during the period for interest		611		

See accompanying notes to unaudited condensed consolidated financial statements.

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**U.S. AUTO PARTS NETWORK, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 Summary of Significant Accounting Policies**

U.S. Auto Parts Network, Inc. (collectively with its subsidiaries, the Company) is a distributor of aftermarket auto parts and accessories and was established in 1995. The Company entered the e-commerce sector by launching its first website in 2000 and currently derives the majority of its revenues from online sales channels. The Company sells its products to individual consumers through a network of websites and online marketplaces. Our flagship websites are located at [www.autopartswarehouse.com](http://www.autopartswarehouse.com), [www.partstrain.com](http://www.partstrain.com), [www.icwhitney.com](http://www.icwhitney.com), [www.stylintrucks.com](http://www.stylintrucks.com) and our corporate website is located at [www.usautoparts.net](http://www.usautoparts.net).

The Company's products consist of body parts, engine parts, performance parts and accessories. The body parts category is primarily comprised of parts for the exterior of an automobile. Our parts in this category are typically replacement parts for original body parts that have been damaged as a result of a collision or through general wear and tear. In addition, we sell an extensive line of mirror products, including our own private-label brand called Kool-Vue, which are marketed and sold as aftermarket replacement parts and as upgrades to existing parts. The engine parts category is comprised of engine components and other mechanical and electrical parts, which are often referred to as hard parts. These parts serve as replacement parts for existing engine parts and are generally used by professionals and do-it-yourselfers for engine and mechanical maintenance and repair. We offer performance versions of many parts sold in each of the above categories. Performance parts and accessories generally consist of parts that enhance the performance of the automobile, upgrade existing functionality of a specific part or improve the physical appearance or comfort of the automobile.

The Company is a Delaware C corporation and is headquartered in Carson, California. The Company also has employees located in, Kansas, Virginia, Illinois and Ohio, as well as in the Philippines.

***Basis of Presentation***

The unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to U.S. Securities and Exchange Commission (SEC) Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of July 2, 2011 and January 1, 2011, and the consolidated results of operations for the thirteen and twenty-six weeks ended July 2, 2011 and July 3, 2010, and cash flows for the twenty-six weeks ended July 2, 2011 and July 3, 2010. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. The Company's results of operations for the thirteen and twenty-six weeks ended July 2, 2011 are not necessarily indicative of those to be expected for the entire year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended January 1, 2011 (fiscal 2010), which was filed with the SEC on March 17, 2011.

***Principles of Consolidation***

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management 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. Significant estimates made by management include, but are not limited to, the valuation of investments, valuation of inventory, valuation of deferred tax assets and liabilities, and valuation of intangible assets, including goodwill. Actual results could differ from these estimates.

***Segment Data***

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The Company manages its operations on a consolidated basis for purposes of assessing performance and making operating decisions. Accordingly, the Company operates in one reportable segment and reporting revenues by product line or geographic location is impracticable.

**Table of Contents****U.S. AUTO PARTS NETWORK, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Recent Accounting Pronouncements***

In December 2010, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* ( ASU 2010-29 ), an update to Accounting Standards Codification ( ASC ) Topic 805, *Business Combinations* ( ASC 805 ). The amendments in ASU 2010-29 specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments in ASU 2010-29 also expand the supplemental pro forma disclosures under ASC 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The Company will apply the provisions of ASU 2010-29 to future acquisitions which occur after January 2, 2011. The Company believes that the adoption will not have a material effect on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ( ASU 2011-04 ), an update to ASC Topic 820, *Fair Value Measurement* ( ASC 820 ). The amendments in ASU 2011-04 are the result of joint efforts by the FASB and International Accounting Standards Board ( IASB ) to develop a single, converged fair value framework and provide converged guidance on how to measure fair value and on what disclosures to provide about fair value measurements. While ASU 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands ASC 820's existing disclosure requirements for fair value measurements and makes other amendments. Many of these amendments were made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards ( IFRSs ). However, some could change how the fair value measurement guidance in ASC 820 is applied. For public entities, amendments are effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the provisions of ASU 2011-04 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. The Company believes that this adoption will not have a material effect on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* ( ASU 2011-05 ), an update to ASC Topic 220, *Comprehensive Income* ( ASC 220 ). The amendments in ASU 2011-05 revise the manner in which entities present comprehensive income in their financial statements by removing the presentation options in ASC 220 and requiring entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The amendments in ASU 2011-5 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company will adopt the provisions of ASU 2011-05 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. This adoption will have an impact on the presentation of other comprehensive income on the Company's consolidated financial statements.

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As of July 2, 2011, the Company held the following securities and investments, recorded at fair value (in thousands):

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
Auction rate preferred securities in municipal and state agencies <sup>(1)</sup>	\$ 3,825	\$	\$ (59)	\$ 3,766
Mutual funds and money market funds <sup>(2)</sup>	1,118		(6)	1,112
<b>Total</b>	<b>\$ 4,943</b>	<b>\$</b>	<b>\$ (65)</b>	<b>\$ 4,878</b>

As of January 1, 2011, the Company held the following securities and investments, recorded at fair value (in thousands):

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
Auction rate preferred securities in municipal and state agencies <sup>(1)</sup>	\$ 4,225	\$	\$ (84)	\$ 4,141
Mutual funds <sup>(2)</sup>	1,070		(8)	1,062
<b>Total</b>	<b>\$ 5,295</b>	<b>\$</b>	<b>\$ (92)</b>	<b>\$ 5,203</b>

<sup>(1)</sup> Auction rate preferred securities ( ARPS ) issued by municipal and state agencies have a maturity of 15 to 30 years and are classified as long-term investments available-for-sale. As of July 2, 2011 and January 1, 2011, all of these securities were held in three tax-exempt municipal bonds managed under closed-end funds and had been in a continuous loss position for more than twelve months.

<sup>(2)</sup> Mutual funds and money market funds are classified as short-term investments available-for-sale and recorded at fair market value, based on quoted prices of identical assets that are trading in active markets as of the end of the period for which the values are determined. Proceeds from the sale of available-for-sale securities are disclosed separately in the accompanying unaudited condensed consolidated statements of cash flows. For the thirteen and twenty-six weeks ended July 2, 2011 and July 3, 2010, there were no recognized gross realized gain and losses.

The accumulated unrealized net loss on the securities and investments at July 2, 2011 and January 1, 2011 was \$0.1 million.

**Note 3 Fair Value Measurements**

Fair value is defined as an exit price representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability.

Provisions of ASC 820 establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

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**Level 1** - Observable inputs such as quoted prices in active markets;

**Level 2** - Inputs other than quoted prices in active markets that are either directly or indirectly observable; and

**Level 3** - Unobservable inputs in which little or no market data exists, therefore, requiring an entity to develop its own assumptions.

**Table of Contents****U.S. AUTO PARTS NETWORK, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Financial Assets Valued on a Recurring Basis***

As of July 2, 2011 and January 1, 2011, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company's financial instruments, including investments associated with the ARPS. The Company measures the following financial assets at fair value on a recurring basis. The fair value of these financial assets was determined using the following inputs at July 2, 2011 and January 1, 2011 (in thousands):

	Total	As of July 2, 2011		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash and cash equivalents <sup>(1)</sup>	\$ 16,249	\$ 16,249	\$	\$
Short-term investments <sup>(2)</sup>	1,112	1,112		
Non-current investments available-for-sale <sup>(3)</sup>	3,766			3,766
	\$ 21,127	\$ 17,361	\$	\$ 3,766

	Total	As of January 1, 2011		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash and cash equivalents <sup>(1)</sup>	\$ 17,595	\$ 17,595	\$	\$
Short-term investments <sup>(2)</sup>	1,062	1,062		
Non-current investments available-for-sale <sup>(3)</sup>	4,141			4,141
	\$ 22,798	\$ 18,657	\$	\$ 4,141

- (1) Cash and cash equivalents consists primarily of money market funds with original maturity dates of three months or less at the date of purchase, for which the Company determines fair value through quoted market prices.
- (2) Short-term investments consist of mutual funds and money market funds. Short-term investments are classified as investments available-for-sale and recorded at fair market value, based on quoted prices of identical assets that are trading in active markets as of the end of the period for which the values are determined.
- (3) As of July 2, 2011, the Company had invested \$3,825 (par value in thousands) in ARPS, which are classified as available-for-sale securities and reflected at \$3,766 (fair value in thousands), which includes an unrealized loss of \$59 (in thousands). As of January 1, 2011, the Company had invested \$ 4,225 (par value in thousands) in ARPS, which were classified as available-for-sale securities and reflected at \$ 4,141 (fair value in thousands), which included an unrealized loss of \$84 (in thousands). The Company has included its investments related to ARPS in the Level 3 category.

Before utilizing Level 3 inputs in fair value measurement, the Company considered significant Level 2 observable inputs of similar assets in active and inactive markets. The Company's broker dealer received estimated market values from an independent pricing service as of the balance sheet date and the anticipated future market for such investments. These investments consist solely of collateralized debt obligations supported by municipal and state agencies; do not include mortgage-backed securities or student loans; have redemption features that call for redemption at 100% of par value; and have a current credit rating of A or AAA. For the period between June 30, 2008 through July 2, 2011, the Company received partial redemptions at par on these investments totaling \$3.9 million. The fact that there is not an active market to liquidate these investments was considered in classifying them as Level 3. Due to the uncertainty with regard to the short-term liquidity of these securities, the Company determined that it could not rely on par value to represent fair value. Therefore, the Company estimated the fair values



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of these securities utilizing a discounted cash flow valuation model as of July 2, 2011 and January 1, 2011. This analysis considered the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation the security will have a successful auction or market liquidity. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company.

As a result of the temporary declines in fair value for the Company's ARPS, which the Company generally attributes to liquidity issues rather than credit issues, the Company recorded an unrealized loss of \$59 and \$84 (in thousands) to accumulated other comprehensive income as of July 2, 2011 and January 1, 2011, respectively. Due to the Company's belief that the market for these collateralized instruments may take in excess of twelve months to fully recover, the Company has classified these investments as noncurrent and has included them in investments on the unaudited condensed consolidated balance sheets at July 2, 2011 and January 1, 2011. As of July 2, 2011, the Company continued to earn interest on all of its ARPS instruments. Any future fluctuation in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income. If the Company determined that any decrease in the value of the instruments was other-than-temporary, it would record a charge to earnings as appropriate. The Company is not certain how long it may be required to hold each security. However, given the Company's current cash position, liquid cash equivalents and expected cash provided by operations, it believes it has the ability to hold, and intends to continue to hold the ARPS as long-term investments until the market for such securities stabilizes.

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During the twenty-six weeks ended July 2, 2011 and the fiscal year ended January 1, 2011, there were no transfers of Level 1 and Level 2 assets. The following tables present the Company's ARPS measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at July 2, 2011 and January 1, 2011 (in thousands):

	<b>Long-Term Investments</b>
Balance as of January 1, 2011	\$ 4,141
Redemption	(400)
Unrealized gains included in other comprehensive income	25
Balance as of July 2, 2011	\$ 3,766
	<b>Long-Term Investments</b>
Balance as of January 2, 2010	\$ 4,264
Redemption	(125)
Unrealized gains included in other comprehensive income	2
Balance as of January 1, 2011	\$ 4,141

***Non-Financial Assets Valued on a Non-Recurring Basis***

The Company's long-lived or indefinite-lived intangible assets are measured at fair value on a non-recurring basis. These assets are measured at cost but are written down to fair value, if necessary, as a result of impairment.

As of July 2, 2011 and January 1, 2011, the Company's long-lived and indefinite-lived intangible assets did not indicate a potential impairment under the provisions of ASC Topic 350, *Intangibles* and ASC Topic 360, *Property, Plant, and Equipment* and, as such, they were not measured at fair value.

**Note 4 Inventory**

Inventories consist entirely of finished goods and are stated at the lower of cost or market value, determined using the first in, first out (FIFO) method. The Company purchases inventory from suppliers both domestically and internationally, and routinely enters into supply agreements with U.S. based suppliers and its primary drop-ship vendors. The Company believes that its inventoried products are generally available from more than one supplier and seeks to maintain multiple sources for its products, both internationally and domestically.

**Note 5 Business Combination**

On August 12, 2010, the Company completed the purchase (the Acquisition) of all of the issued and outstanding shares of Automotive Specialty Accessories and Parts (WAG), a leader in the automobile aftermarket performance parts and accessories market. Assets acquired include intangible assets consisting of customer relationships, technology, and trade names, tangible assets such as furniture and fixtures, machinery and equipment, and a 350,000 square foot distribution center in LaSalle, Illinois with a headquarter office located in Chicago, Illinois. The final purchase price of WAG was \$26.7 million in cash, including certain adjustments as set forth in that certain Stock Purchase Agreement executed August 2, 2010 (the Purchase Agreement) among Go Fido, Inc., WAG, 2000 Riverside Capital Appreciation Fund, L.P. and the other stockholders of WAG. The Acquisition provided the Company with product line expansion into all terrain vehicles, recreational vehicles and motorcycles, as well as deep product knowledge into niche segments like Jeep, Volkswagen and truck enthusiasts. This expansion in its product

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line has increased its customer reach in the do-it-yourself automobile and off-road accessories market. In addition, WAG's state-of-the-art facility located in Illinois, which was custom built for business-to-consumer distribution of auto parts, allowed the Company to complete a three-distribution center network. The Company believes that the combination of WAG's established brands and focus on the customer experience, coupled with the Company's capacity to compete online, creates opportunity for growth. These expected synergies from the Acquisition contributed to the goodwill associated with the Acquisition of \$7.6 million. See the purchase price allocation table below for further details.

The Acquisition has been accounted for under the purchase method of accounting in accordance with ASC 805. Accordingly, the assets and liabilities of WAG have been recorded as of the acquisition date at their respective fair values, and combined with the Company's assets and liabilities. The determination of estimated fair value requires management to make significant estimates and assumptions. The results of operations of WAG and the estimated fair market values of the acquired assets and liabilities have been included in the consolidated financial statements from the date of the Acquisition.

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The following table summarizes our allocation of the purchase price for the Acquisition to the estimated fair values of the assets acquired and liabilities assumed at the date of the Acquisition (in thousands):

Purchase price paid in cash (1)	\$ 27,500
Purchase price adjustment (2)	(787)
<b>Final purchase price</b>	<b>\$ 26,713</b>
Purchase price allocation is presented below:	
Assets:	
Accounts receivable	2,642
Inventory	12,366
Deferred income taxes	120
Property and equipment	16,430
Intangible assets	17,378
Other assets	2,287
Total assets	\$ 51,223
Liabilities:	
Accounts payable	\$ (23,542)
Accrued expenses	(4,534)
Deferred income taxes	(2,734)
Other liabilities	(1,272)
Total liabilities	\$ (32,082)
Goodwill (3)	\$ 7,572
<b>Final purchase price</b>	<b>\$ 26,713</b>

(1) Represents the purchase price paid in cash at the closing of the Acquisition of \$27.5 million.

(2) The purchase price adjustment of \$787 (in thousands) represents the settlement amount that shareholders of WAG paid to USAP for the negative working capital amount of WAG on the date of the Acquisition. The net working capital of WAG on the date of the Acquisition was determined in accordance with the definitions and procedures set forth in the Purchase Agreement.

(3) The goodwill resulting from the Acquisition is non-deductible for tax purposes.

Of the total purchase price, approximately \$8.2 million has been allocated to trade name assets with an indefinite life and \$9.2 million has been allocated to amortizable intangible assets acquired. The amortizable intangible assets are being amortized on a straight line basis over their respective useful lives except for internet platform intellectual property which is being amortized on an accelerated basis over 10 months based on the Company's estimated usage of the asset as follows:

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	Weighted-Average Useful Life	Gross Carrying Amount (in thousands)
Intangible assets subject to amortization:		
Internet platform intellectual property	10 months	\$ 4,300
Product design intellectual property	9 years	2,750
Customer relationships	4 years	2,050
Favorable leases	2.5 years	78
		9,178
Intangible assets not subject to amortization:		
Trade names	indefinite life	8,200
<b>Total</b>		<b>\$ 17,378</b>

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WAG's financial results have been included in our consolidated statement of operations since the acquisition date of August 12, 2010. Therefore, pro forma information for the thirteen and twenty-six weeks ended July 2, 2011 has not been presented since the results of operations of WAG have been included in our actual consolidated results of operations for the entire period. The following pro forma financial information presents the results as if the Acquisition had occurred on January 3, 2010 (in thousands, except share and per share amounts):

	<b>Thirteen Weeks Ended July 3, 2010</b>	<b>Twenty-six Weeks Ended July 3, 2010</b>
Net sales	\$ 89,524	\$ 174,641
Net loss	(8,142)	(20,912)
Basic net loss per share	(0.27)	(0.69)
Diluted net loss per share	(0.27)	(0.69)
Weighted average shares used in computing basic net loss per common share	30,314,478	30,158,797
Weighted average shares used in computing diluted net loss per common share	30,314,478	30,158,797

Related to the Acquisition, the Company has incurred acquisition and integration related costs of \$5.9 million, which have been recorded in general and administrative expenses.

**Note 6 Goodwill and Intangibles**

The following table summarizes the change in our goodwill during the twenty-six weeks ended July 2, 2011 as follows (in thousands):

Balance at January 1, 2011	\$ 17,137
Change in goodwill	207
<b>Balance at July 2, 2011</b>	<b>\$ 17,344</b>

During the thirteen weeks ended July 2, 2011, the Company recorded goodwill adjustments of \$207 (in thousands) related to the settlement amount that the Company received from the shareholders of WAG for the negative working capital amount of WAG on the date of the Acquisition. During the twenty-six weeks ended July 2, 2011, no additional goodwill was recorded.

The Company evaluates goodwill for impairment on an annual basis or more frequently if events or circumstances occur that would indicate a reduction in fair value. As of October 31, 2010, the Company performed its annual impairment test and the excess of fair value estimates over carrying value for our reporting unit was approximately \$187 million. Based on its analysis, there would have to be a 65% decrease in the fair value of the reporting unit to fail step 1. During the twenty-six weeks ended July 2, 2011, there was no change to the Company's reporting unit and no events or circumstances occurred that would indicate a reduction in fair value. The accumulated impairment loss on goodwill was \$4.4 million as of July 2, 2011 and January 1, 2011.

Intangibles subject to amortization are expensed on a straight-line basis. Amortization expense relating to intangibles totaled \$1,363 and \$2,990 (in thousands) for the thirteen and twenty-six weeks ended July 2, 2011, respectively. Amortization expense relating to intangibles totaled \$124 and \$245 (in thousands) for the thirteen and twenty-six weeks ended July 3, 2010, respectively. During the thirteen and twenty-six weeks ended July 2, 2011, the Company purchased certain domain and trade names for a purchase price of \$22 (in thousands) and \$48 (in thousands), respectively. All of these assets were allocated to intangible assets not subject to amortization.



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Intangibles, excluding goodwill, consisted of the following at July 2, 2011 and January 1, 2011 (in thousands):

	Useful Life	July 2, 2011			January 1, 2011		
		Gross Carrying Amount	Accum. Amort.	Net Carrying Amount	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount
Intangible assets subject to amortization:							
Websites	5 years	\$ 2,035	\$ (798)	\$ 1,237	\$ 2,035	\$ (594)	\$ 1,441
Internet platform intellectual property <sup>(1)</sup>	10 months	4,300	(4,300)		4,300	(1,984)	2,316
Product design intellectual property <sup>(1)</sup>	9 years	2,750	(265)	2,485	2,750	(116)	2,634
Customer relationships <sup>(1)</sup>	4 years	2,050	(455)	1,595	2,050	(197)	1,853
Assembled workforce	7 years	483	(228)	255	478	(182)	296
Favorable lease <sup>(1)</sup>	2.5 years	78	(31)	47	78	(14)	64
Sub-Total		11,696	(6,077)	5,619	11,691	(3,087)	8,604
Intangible assets not subject to amortization:							
Domain and trade names <sup>(2)</sup>	Indefinite life	10,162		10,162	10,114		10,114
<b>Total</b>		<b>\$ 21,858</b>	<b>\$ (6,077)</b>	<b>\$ 15,781</b>	<b>\$ 21,805</b>	<b>\$ (3,087)</b>	<b>\$ 18,718</b>

(1) Includes the intangible assets acquired in connection with the Acquisition.

(2) Includes domain names assigned a value of \$8.2 million purchased in connection with the Acquisition.

The following table summarizes the future estimated amortization expense for these assets over the next five years (in thousands):

2011	\$ 675
2012	1,344
2013	1,281
2014	881
2015	303
Thereafter	1,135
<b>Total</b>	<b>\$ 5,619</b>

**Note 7 Borrowings**

In August 2010, the Company executed a Loan and Security Agreement (the "Loan Agreement") and other definitive documentation for a \$35 million secured credit facility (the "Facility"). Silicon Valley Bank ("Bank") is the lender under the Facility. The Facility is comprised of a term loan in the original principal amount of \$25 million and a revolving line of credit with availability up to \$10 million. The Facility has a final maturity date of June 30, 2014, and borrowings under the Facility bear interest, at the election of the Company, at LIBOR (with a floor of 1.25%) plus a margin of from 2.00% to 3.00% per annum, or at the Wall Street Journal Prime Rate plus a margin of from 1.00% to 2.00% per annum, based upon the Company's maximum funded debt ratio. An unused revolving line fee of 0.375% per annum is payable on the undrawn committed amount of the revolving line of credit. Interest on outstanding borrowings under the term loan and the revolving line of credit is payable no less



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than quarterly and the outstanding principal of the term loan is amortized over four years and payable quarterly, with any outstanding amount under the Facility to be paid in full on the final maturity date. Borrowings under the Facility are secured by liens over all assets of the Company, including shares of stock in each of the Company's subsidiaries. Ten of the Company's subsidiaries are acting as co-borrowers under the Facility.

The Loan Agreement requires the Company to comply with a number of restrictive covenants, including financial covenants related to maximum funded debt to consolidated EBITDA, liquidity, and consolidated fixed charge coverage ratios; negative pledge requirements; requirements

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**U.S. AUTO PARTS NETWORK, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

to deliver quarterly and annual consolidated financial statements; requirements to maintain adequate insurances; prohibitions on changes in the business and disposition of the Company's assets; and other customary covenants. The Loan Agreement also requires the Company to obtain a prior written consent from the Bank when the Company determines to pay any dividends on or make any distribution related to its common stock. The Loan Agreement includes usual and customary events of default and remedies for facilities of this nature. In February 2011, the Company and the Bank entered into Amendment No. 1 to Loan and Security Agreement and Limited Waiver ( Amendment ). The Amendment waived the Company's lack of compliance with the consolidated fixed charge coverage ratio covenant in the Loan Agreement as of January 1, 2011. The Amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA to more readily accommodate the Company's integration of the WAG acquisition. For the thirteen and twenty-six weeks ended July 2, 2011, the Company was in compliance with all covenants under the credit facility.

The Loan Agreement, as amended by the Amendment, contains the following financial covenants:

Maximum funded debt to consolidated EBITDA. A ratio of aggregate credit extensions outstanding to trailing 12 month consolidated EBITDA of not greater than the following:

2.25:1.00 from effective date through quarter ending September 30, 2010

2.00:1.00 for quarters ending December 31, 2010 through June 30, 2011

1.50:1.00 for quarters ending September 30, 2011 through June 30, 2012

1.00:1.00 for each quarter ending thereafter

Consolidated fixed charge coverage ratio for the period set forth below of not less than the ratio set forth below:

1.10:1.00 for two quarters ending December 31, 2010

1.25:1.00 for three quarters ending March 31, 2011

1.25:1.00 for four quarters ending June 30, 2011, September 30, 2011 and December 31, 2011

1.50:1.00 for each quarter ending thereafter

Liquidity as follows:

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Unrestricted cash and cash equivalents (less outstanding advances) should be greater than \$7,500,000 plus integration capital expenditures added back.

The Company's financial covenant ratios under the Loan Agreement as of July 2, 2011 were 1.16:1.00 for maximum funded debt to consolidated EBITDA and 1.58:1.00 for consolidated fixed charge coverage. As of July 2, 2011, the Company's required liquidity under the Loan Agreement was \$11,400,000, and adding back the integration capital expenditures, the Company's liquidity was \$17,362,000.

The Company expects to be in compliance with the financial covenants in the Loan Agreement through the term of the Loan Agreement. However, it is possible that a default under certain financial covenants may occur in the future, should the Company's forecasted EBITDA levels not be achieved. If the Company defaults on any of the covenants under the Loan Agreement and is unable to obtain waivers from the Bank, the Bank will be able to exercise their rights and remedies under the Loan Agreement, including a call provision on outstanding debt, which would have a material adverse effect on the Company's business and financial condition.

At July 2, 2011, the LIBOR rate and the margin were 1.25% and 2.50% per annum, respectively. The Company had no borrowings on the revolving line of credit at July 2, 2011. The remaining term loan balance was \$21 million as of July 2, 2011 and is to be repaid according to the following schedule (in thousands):

Total	Payments Due by Period			
	2011	2012	2013	2014
\$21,000	\$3,125	\$6,250	\$6,875	\$4,750

Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of our long-term debt under the facility approximated its carrying amount as of July 2, 2011.

### Note 8 Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC Topic 718, *Stock Compensation* (ASC 718). All stock options issued to employees are recognized as share-based compensation expense in the financial statements based on their respective grant date fair values, and are recognized within the statements of operations as general and administrative, marketing, fulfillment or technology expense, based on employee departmental classifications.

Under these guidelines, the fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. The Company currently uses the Black-Scholes option pricing model to estimate the fair value of share-based payment awards. The determination of the fair value of share-based payment awards utilizing the Black-Scholes option pricing model is affected by the Company's stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. As of July 2, 2011, the Company did not have an adequate history of market prices of its common stock as the Company recently became a public company, and as such, the Company estimates volatility using historical volatilities of similar public entities. The expected life of the awards is based on a simplified method which defines the life as the average of the contractual term of the options and the weighted average vesting period for all open tranches. Due to the limited period of time our equity shares have been publicly traded, we do not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of awards. The dividend yield assumption is based on the Company's expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company considers many factors when estimating expected forfeitures, including employee class, economic environment, and historical experience. Share-based compensation expense recognized in our financial statements is based on awards that are ultimately expected to vest. If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested options, we may be required to accelerate, increase or cancel any remaining unrecognized share-based compensation expense.

The Company also accounts for equity instruments issued in exchange for board services rendered by non-employee directors in accordance with the provisions of ASC 718.

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from non-employees in accordance with ASC 505-50, *Equity-Based Payments to Non-Employees*. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration for other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services. Equity instruments awarded to non-employees are periodically re-measured as the underlying awards vest unless the instruments are fully vested, immediately exercisable and non-forfeitable on the date of grant.



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Under the Company's 2007 Omnibus Incentive Plan, the Company granted stock options to purchase 120,000 shares of common stock during the thirteen weeks ended July 2, 2011 at a weighted-average grant date fair value of \$7.43. The Company granted stock options to purchase 660,000 shares of common stock during the twenty-six weeks ended July 2, 2011 at a weighted-average grant date fair value of \$7.75. The Company had \$3.4 million of unrecognized share-based compensation expense related to stock options outstanding as of July 2, 2011, which expense is expected to be recognized over a weighted-average period of 2.35 years. During the thirteen weeks ended July 2, 2011, options to purchase 40,991 shares were exercised and the total intrinsic value of the exercised options was \$0.2 million. During the twenty-six weeks ended July 2, 2011, options to purchase 70,991 shares were exercised and the total intrinsic value of the exercised options was \$0.3 million. The intrinsic value of stock options at the date of the exercise is the difference between the fair value of the stock at the date of exercise and the exercise price. At July 2, 2011, 2,585,395 shares of common stock were available for future grants under this plan.

Under the Company's 2007 New Employee Incentive Plan, there were no stock options granted during the twenty-six weeks ended July 2, 2011. The Company had \$0.1 million of unrecognized share-based compensation expense related to stock options outstanding under this plan as of July 2, 2011, which expense is expected to be recognized over a weighted-average period of 1.26 years. During the twenty-six weeks ended July 2, 2011, there were no options exercised under this plan. At July 2, 2011, 750,000 shares of common stock were available for future grants under this plan.

Under the Company's 2006 Equity Incentive Plan, there were no stock options granted during the twenty-six weeks ended July 2, 2011. The Company had no unrecognized share-based compensation expense related to stock options outstanding under this plan as of July 2, 2011. During the twenty-six weeks ended July 2, 2011, there were no options exercised under this plan. As of July 2, 2011, there were 2,758,095 shares of common stock available for future grants under this plan.

On May 5, 2009, the Company issued warrants to purchase up to 30,000 shares of common stock, which warrants terminate seven years after their grant date. The warrants were issued in connection with the financial advisory services provided by a consultant to the Company. The warrants vest in thirty-six equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing May 5, 2009. The re-measured fair value of these warrants was \$5.87 per share at July 2, 2011. On April 27, 2010, the Company issued additional warrants to purchase up to 20,000 shares of common stock to the same holder in connection with the financial advisory services provided to the Company. The warrants vest in twenty-four equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing April 27, 2010. The re-measured fair value of these warrants was \$3.18 per share at July 2, 2011. The Company determined the fair value of the warrants using the Black-Scholes option pricing model based on the estimated fair value of the underlying common stock. There were no warrants exercised during the twenty-six weeks ended July 2, 2011.

**Note 9 Income Taxes**

For the thirteen weeks ended July 2, 2011 and July 3, 2010, the effective tax rate for the Company was (8.2)% and 32.8%, respectively. For the twenty-six weeks ended July 2, 2011 and July 3, 2010, the effective tax rate for the Company was (8.2)% and 36.9%, respectively. The Company's effective tax rate for the thirteen and twenty-six weeks ended July 2, 2011 differed from the U.S. federal statutory rate primarily due to an increase in valuation allowance against pre-tax operating losses and recording of provision for increasing long-term deferred tax liabilities associated with indefinite-lived intangibles which would not be offset with the operating losses. The increase in the valuation allowance was due to uncertainty regarding the future realization of the deferred tax assets established by the entity.

As of July 2, 2011, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. The Company's policy is to record accrued interest and penalties related to unrecognized tax benefits as income tax expense.

The Company is subject to U.S. federal income tax as well as income tax of foreign and state tax jurisdictions. The Company's foreign and state income tax returns are open to audit under the statute of limitations for the tax years 2006 through 2010. The Company does not anticipate a significant change to the total amount of unrecognized tax benefits within the next twelve months.

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The Company reports comprehensive (loss) income in accordance with ASC Topic 220, *Comprehensive Income*, which defines comprehensive (loss) income as net (loss) income affected by non-stockholder changes in equity. Comprehensive (loss) income for the thirteen and twenty-six weeks ended July 2, 2011 and July 3, 2010 was as follows (in thousands):

	<b>Thirteen Weeks Ended July 2, 2011</b>	<b>Thirteen Weeks Ended July 3, 2010</b>	<b>Twenty-Six Weeks Ended July 2, 2011</b>	<b>Twenty-Six Weeks Ended July 3, 2010</b>
Net (loss) income	\$ (2,564)	\$ 462	\$ (2,810)	\$ 2,009
Foreign currency translation adjustments	14	(75)	33	13
Unrealized gain (loss) in investments	16	75	27	66
Comprehensive (loss) income	\$ (2,534)	\$ 462	\$ (2,750)	\$ 2,088

**Note 11 Net (Loss) Income Per Share**

Basic net (loss) income per share is computed by dividing net (loss) income by the weighted average number of common shares outstanding for the period. Diluted earnings per share is applicable only in periods of net income and is computed by dividing net income by the weighted average number of common shares outstanding for the period and potentially dilutive common stock equivalents outstanding for the period. Periods of net loss require the diluted computation to be the same as the basic computation. Due to the loss in the thirteen and twenty-six weeks ended July 2, 2011, 1,566,880 and 1,663,170 shares, respectively, have been excluded from the computation of diluted net (loss) income per share.

Net (loss) income per share has been computed in accordance with ASC Topic 260, *Earnings Per Share*. The following table sets forth the computation of basic and diluted net (loss) income per share (in thousands, except share and per share data):

	<b>Thirteen Weeks Ended July 2, 2011</b>	<b>Thirteen Weeks Ended July 3, 2010</b>	<b>Twenty-Six Weeks Ended July 2, 2011</b>	<b>Twenty-Six Weeks Ended July 3, 2010</b>
<b><i>Net (Loss) Income Per Share</i></b>				
Numerator:				
Net (loss) income	\$ (2,564)	\$ 462	\$ (2,810)	\$ 2,009
Denominator:				
Weighted-average common shares outstanding (basic)	30,543,037	30,314,478	30,496,558	30,158,797
Common equivalent shares from common stock options and warrants		1,679,969		1,564,519
Weighted-average common shares outstanding (diluted)	30,543,037	31,994,447	30,496,558	31,723,316
Basic net (loss) income per share	\$ (0.08)	\$ 0.02	\$ (0.09)	\$ 0.07
Diluted net (loss) income per share	\$ (0.08)	\$ 0.01	\$ (0.09)	\$ 0.06

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Potentially dilutive securities were not included in the calculation of diluted net income per share because these securities would be anti-dilutive due to the Company's stock price. The related securities are as follows (in common equivalent shares):

	<b>Thirteen Weeks Ended July 2, 2011</b>	<b>Thirteen Weeks Ended July 3, 2010</b>	<b>Twenty-Six Weeks Ended July 2, 2011</b>	<b>Twenty-Six Weeks Ended July 3, 2010</b>
Warrants to purchase common stock	20,000	8,132	20,000	4,066
Options to purchase common stock	2,246,048	1,409,478	1,801,597	1,369,333
<b>Total</b>	<b>2,266,048</b>	<b>1,417,610</b>	<b>1,821,597</b>	<b>1,373,399</b>

### **Note 12 Deferred Compensation Plan**

In January 2010, the Company adopted the U.S. Auto Parts Network, Inc. Management Deferred Compensation Plan (the "Deferred Compensation Plan"), for the purpose of providing highly compensated employees a program to meet their financial planning needs. The Deferred Compensation Plan provides participants with the opportunity to defer up to 90% of their base salary and up to 100% of their annual earned bonus, all of which, together with the associated investment returns, are 100% vested from the outset. The Deferred Compensation Plan, which is designed to be exempt from most provisions of the Employee Retirement Security Act of 1974, is informally funded by the Company through the purchase of Company-owned life insurance policies with the Company as the owner and beneficiary, in order to preserve the tax-deferred savings.

**Table of Contents****U.S. AUTO PARTS NETWORK, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

advantages of a non-qualified plan. The Deferred Compensation Plan assets are the cash surrender value of the Company-owned life insurance policies and not associated with the deferred compensation liability. The deferred compensation liabilities (consisting of employer contributions, employee deferrals and associated earnings and losses) are general unsecured obligations of USAP. Liabilities under the Deferred Compensation Plan are recorded at amounts due to participants, based on the fair value of participants' selected investments. The Company may at its discretion contribute certain amounts to eligible employee accounts. In January 2010, the Company began to contribute 50% of the first 2% of participants' eligible contributions into their Deferred Compensation Plan accounts. In September 2010, the Company established and transferred its ownership to a rabbi trust to hold the Company-owned life insurance policies. As of July 2, 2011, the assets and associated liabilities of the Deferred Compensation Plan were \$550,000 and \$358,000, respectively, and are included in other non-current assets and non-current liabilities, respectively, in our consolidated balance sheets. The associated liabilities mainly include the employee contributions of \$299,000 and the Company contributions of \$59,000 made as of July 2, 2011. Included in other income, the Company recorded a loss of \$3,000 and a gain of \$9,000 for the change in the cash surrender value of the Company-owned life insurance policies during the thirteen and twenty-six weeks ended July 2, 2011, respectively.

**Note 13 Contingencies*****Parts Geek Litigation***

In June 2009, the Company filed suit in the United States District Court for the Central District of California against Parts Geek LLC (Parts Geek), certain of its members and employees for misappropriation of trade secrets, breach of contract and unfair competition and requesting monetary damages and injunctive relief, and Parts Geek filed an answer in August 2009. In January 2010, the complaint was amended to include claims for copyright infringement and to add Lucas Thomason, a former employee, as an additional party. Parts Geek filed an answer and counterclaims to the amended complaint in February 2010. Each party filed a motion for summary judgment requesting that the Court rule on all claims made in this matter without sending the matter to a jury. In June 2010, the Court ruled on all claims in the matter, denying the Company's claims against Parts Geek and Lucas Thomason and denying Parts Geek's claims against the Company. The judge additionally denied Parts Geek's counterclaims against the Company. Parts Geek and Lucas Thomason petitioned the Court to order the Company to pay their legal fees and costs, the Court ordered the Company to do so and in August 2010 all parties stipulated that approximately \$1.1 million of legal fees and costs would be owed to Parts Geek and Lucas Thomason should the Company lose its appeal or win its appeal and lose in trial. A bond has been posted to guarantee payment of \$1.1 million plus interest, at a cost of approximately \$0.02 million to the Company. The Company is not required to pay the fees and costs at this time; they would be due if the Company loses its appeal and determines to not appeal beyond the 9th Circuit Court of Appeals, or if the Company wins on appeal but loses at trial once the case is remanded to the trial court and, in accordance with ASC 450-20 *Loss Contingencies* (ASC 450-20), the Company has not accrued for these fees and costs. The Company filed an appeal and filed its initial brief on January 21, 2011. The reply brief was filed March 21, 2011. The appeal has been fully briefed by all parties and scheduling of oral argument before the 9th Circuit Court of Appeals is pending. The Company has analyzed this matter in accordance with ASC 450-20 and, in accordance with the definition of probable loss described therein, it has concluded that no accrual is necessary at this time.

***California Air Resources Board Inquiry***

The Company received an inquiry by the California Air Resources Board (CARB) into sales of non-California compliant catalytic converters in the state of California via our stock-ship and drop-ship network. In March 2010, and again in June 2010, the Company met with CARB to discuss alleged sales of catalytic converters into California by the Company and third-party suppliers that are not compliant with California regulations. CARB informed the Company that penalties shall be assessed with regard to any non-compliant sales; discussions are ongoing, and due to a number of variables, any penalties are not estimable at this time. This will impact the sale of products for emissions systems in California and may adversely impact our sales and operating results. The Company is unable to assess the amount of the final monetary cost in this regard, other than legal fees that have been and may continue to be incurred in preparing responses and defending the Company in the inquiry and that there will be an associated cost for penalties in this matter.

***Asbestos***

WAG is a named defendant in several lawsuits involving claims for damages caused by installation of brakes during the late 1960's and early 1970's that contained asbestos. WAG marketed certain brakes, but did not manufacture any brakes. WAG maintains liability insurance coverage



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to protect its and the Company's assets from losses arising from the litigation and coverage is provided on an occurrence rather than a claims made basis, and the Company is not expected to incur significant out-of-pocket costs in connection with this matter that would be material to its consolidated financial statements.

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### **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Cautionary Statement**

*You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC, including our Annual Report on Form 10-K for the year ended January 1, 2011 and subsequent reports on Forms 10-Q and 8-K, which discuss our business in greater detail. The section entitled Risk Factors set forth below, and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition in the future. You should carefully consider those risks, in addition to the other information in this report and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.*

#### **Overview**

We are one of the largest online providers of aftermarket auto parts, including body parts, engine parts, and performance parts and accessories. Our user-friendly websites provide customers with a broad selection of Stock Keeping Units ( SKUs ), with detailed product descriptions and photographs. Our proprietary product database maps our SKUs to product applications based on vehicle makes, models and years. We principally sell our products to individual consumers through our network of websites and online marketplaces. Our flagship websites are located at [www.autopartswarehouse.com](http://www.autopartswarehouse.com), [www.partstrain.com](http://www.partstrain.com), [www.jcwhitney.com](http://www.jcwhitney.com), [www.stylintrucks.com](http://www.stylintrucks.com), [www.AutoMD.com](http://www.AutoMD.com) and our corporate website is located at [www.usautoparts.net](http://www.usautoparts.net). We believe our strategy of disintermediating the traditional auto parts supply chain and selling products directly to customers over the Internet allows us to more efficiently deliver products to our customers while generating higher margins.

*Our History.* We were formed in Delaware in 1995 as a distributor of aftermarket auto parts and launched our first website in 2000. We rapidly expanded our online operations, increasing the number of SKUs sold through our e-commerce network, adding additional websites, , improving our internet marketing proficiency and commencing sales in online marketplaces. Additionally, in August 2010, through our acquisition of WAG, we expanded our product-lines and increased our customer reach in the do-it-yourself automobile and off-road accessories market. As a result, our business has grown since 2000, generating net sales of \$262 million for fiscal 2010.

*International Operations.* In April 2007, we entered into a purchase agreement to bring in-house certain sales and customer service employees based in the Philippines, who were providing support to us through our outsourced call center provider, Access Worldwide. As of the closing of this transaction, approximately 171 of the Access Worldwide employees had agreed to transition over to direct employment by our Philippines subsidiary. The purchase price for the right to acquire this assembled workforce was approximately \$1.7 million. We had 1,014 employees in our Philippines operations as of July 2, 2011. In addition to our Philippines operations, we own a Canadian subsidiary to facilitate sales of our products in Canada which currently has no employees. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a cost-effective manner, and we expect to continue to add headcount and infrastructure to our offshore operations.

*Acquisitions.* From time to time, we may acquire certain businesses, websites, domain names, or other assets. In the third quarter of fiscal 2009, we completed the acquisition of the assets of a small website and the related domain names which further expanded and enhanced our product offering and our ability to reach more customers. In the first quarter of fiscal 2010, we completed two additional website and domain name asset acquisitions, which we expect will increase our net sales and internet traffic. In August 2010, Go Fido, Inc., a wholly-owned subsidiary of ours, completed the purchase of all of the outstanding capital stock of WAG. WAG's state-of-the-art facility in Illinois expands our distribution network and the merchandise WAG offers extends our go to market product-lines into all terrain vehicles, recreational vehicles and motorcycles, as well as provides us with deep product knowledge into niche segments like Jeep, Volkswagen and trucks. This expansion of our product line increases our customer reach in the do-it-yourself automobile and off-road accessories market. For additional information, see *Note 5 Business Combination* of the Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report. We may pursue additional acquisition opportunities in the future to increase our share of the aftermarket auto parts market or expand our product offering.

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### Executive Summary

We reported net sales for the quarter ended July 2, 2011 ( Q2 2011 ) of \$84.3 million compared with the quarter ended July 3, 2010 ( Q2 2010 ) net sales of \$53.2 million. Excluding \$24.8 million of revenues from the acquisition of WAG, net sales were \$59.5 million, an increase of 11.8% over Q2 2010 net sales. Q2 2010 net sales include the impact of a \$2.0 million non-cash reduction of reported sales from a change in the Company's revenue recognition. Excluding the impact of the change in revenue recognition on Q2 2010 sales, net sales for Q2 2011 increased 7.8%. Q2 2011 net loss was \$2.6 million or \$0.08 per share, compared with Q2 2010 net income of \$0.5 million or \$0.01 per diluted share. Q2 2011's net loss includes a net loss of \$4.1 million or \$0.13 per share related to WAG of which \$1.5 million of the loss, net of tax was attributable to restructuring and integration expenses. We generated Adjusted EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization plus additional adjustments of current year's stock compensation, legal costs to enforce intellectual property rights, charge for change in revenue recognition, and restructuring expenses related to acquisition) of \$4.6 million for the quarter compared to \$5.0 million for Q2 2010. Excluding WAG's Adjusted EBITDA of \$(0.6) million and related \$1.5 million of restructuring and integration expenses as well as \$0.2 million of legal fees to protect intellectual property; Adjusted EBITDA was \$5.2 million, an increase of 3.8% over Q2 2010. Adjusted EBITDA is presented because such measure is used by rating agencies, securities analysts, investors and other parties in evaluating us. It should not be considered, however, as an alternative to operating income as an indicator of our operating performance or as an alternative to cash flows as measures of our overall liquidity as presented in our unaudited condensed consolidated financial statements. Further, Adjusted EBITDA measure shown for us may not be comparable to similarly titled measures used by other companies.

To understand revenue generation through our network of e-commerce websites, we monitor several key business metrics, including the following:

*Unique Visitors:* A unique visitor to a particular website represents a user with a distinct IP address that visits that particular website. We define the total number of unique visitors in a given month as the sum of unique visitors to each of our websites during that month. We measure unique visitors to understand the volume of traffic to our websites and to track the effectiveness of our online marketing efforts. The number of unique visitors has historically varied based on a number of factors, including our marketing activities and seasonality. We believe an increase in unique visitors to our websites will result in an increase in the number of orders. We seek to increase the number of unique visitors to our websites by attracting repeat customers and improving search engine marketing and other internet marketing activities.

*Total Number of Orders:* We monitor the total number of orders as an indicator of future revenue trends. We recognize revenue associated with an order when the products have been delivered, consistent with our revenue recognition policy.

*Average Order Value:* Average order value represents our net sales on a placed orders basis for a given period of time divided by the total number of orders recorded during the same period of time. We seek to increase the average order value as a means of increasing net sales. Average order values vary depending upon a number of factors, including the components of our product offering, the order volume in certain online sales channels, macro-economic conditions, and the general level of competition online.

The tables below reconcile net (loss) income to adjusted EBITDA on both a consolidated basis and for US Auto Parts excluding the WAG acquisition for the periods presented (in thousands):

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
<b>Consolidated</b>				
Net (loss) income	\$ (2,564)	\$ 462	\$ (2,810)	\$ 2,009
Interest expense (income), net	172	(34)	437	(55)
Income tax provision	195	225	213	1,175
Amortization of intangibles	1,363	124	2,990	245
Depreciation and amortization	3,072	1,950	6,075	3,934
<b>EBITDA</b>	<b>2,238</b>	<b>2,727</b>	<b>6,905</b>	<b>7,308</b>
Share-based compensation	643	612	1,324	1,472
	161	1,246	232	1,886

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Legal costs to enforce intellectual property rights				
Charge for change in revenue recognition		411		411
Add back legal restructuring	4		26	
Add back other restructuring	1,538		2,749	
Adjusted EBITDA	\$ 4,584	\$ 4,996	\$ 11,236	\$ 11,077

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	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
<b>USAP excluding WAG</b>				
Net income	\$ 1,486	\$ 462	\$ 4,403	\$ 2,009
Interest expense (income), net	173	(34)	439	(55)
Income tax provision	140	225	158	1,175
Amortization of intangibles	125	124	249	245
Depreciation and amortization	2,459	1,950	4,851	3,934
<b>EBITDA</b>	<b>4,383</b>	<b>2,727</b>	<b>10,100</b>	<b>7,308</b>
Share-based compensation	643	612	1,324	1,472
Legal costs to enforce intellectual property rights	161	1,246	232	1,886
Charge for change in revenue recognition		411		411
<b>Adjusted EBITDA</b>	<b>\$ 5,187</b>	<b>\$ 4,996</b>	<b>\$ 11,656</b>	<b>\$ 11,077</b>

**Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, intangible and other long-lived assets and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. There were no significant changes to our critical accounting policies during the twenty-six weeks ended July 2, 2011, as compared to those policies disclosed in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

**Recent Accounting Pronouncements**

In December 2010, the FASB issued ASU 2010-29, an update to ASC 805. The amendments in ASU 2010-29 specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments in ASU 2010-29 also expand the supplemental pro forma disclosures under ASC 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. We will apply the provisions of ASU 2010-29 to future acquisitions occur after January 2, 2011. We believe that the adoption will not have a material effect on our consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04), an update to ASC Topic 820, *Fair Value Measurement* (ASC 820). The amendments in ASU 2011-04 are the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework and provide converged guidance how to measure fair value and on what disclosures to provide about fair value measurements. While ASU 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands ASC 820's existing disclosure requirements for fair value measurements and makes other amendments. Many of these amendments were made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards (IFRSs). However, some could change how the fair value measurement guidance in ASC 820 is applied. For public entities, amendments are effective for interim and annual periods beginning after December 15, 2011. We will adopt the provisions of ASU 2011-04 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. We believe that the adoption will not have a material effect on our consolidated financial statements.

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In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* ( ASU 2011-05 ), an update to ASC Topic 220, *Comprehensive Income* ( ASC 220 ). The amendments in ASU 2011-05 revise the manner in which entities present comprehensive income in their financial statements by removing the presentation options in ASC 220 and requiring entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The amendments in ASU 2011-5 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. We will adopt the provisions of ASU 2011-05 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. This adoption will have an impact on the presentation of other comprehensive income on the Company's consolidated financial statements.

**Results of Operations**

The following table sets forth certain unaudited statements of operations data for the periods indicated:

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	66.3	65.4	65.6	65.1
Gross profit	33.7	34.6	34.4	34.9
Operating expenses:				
Marketing	17.0	13.5	16.3	13.1
General and administrative	10.0	12.0	9.7	11.1
Fulfillment	5.4	5.5	5.6	5.6
Technology	2.3	2.2	2.3	2.1
Amortization of intangibles	1.6	0.2	1.7	0.2
Total operating expenses	36.3	33.4	35.6	32.1
(Loss) income from operations	(2.6)	1.2	(1.2)	2.8
Other income (expense):				
Other income	0.0	0.0	0.0	0.0
Interest (expense) income	(0.2)	0.1	(0.3)	0.1
Total other (expense) income, net	(0.2)	0.1	(0.3)	0.1
(Loss) income before income taxes	(2.8)	1.3	(1.5)	2.9
Income tax provision	0.2	0.4	0.1	1.1
Net (loss) income	(3.0)%	0.9%	(1.6)%	1.8%

***Thirteen and Twenty-Six Weeks Ended July 2, 2011 Compared to Thirteen and Twenty-Six Weeks Ended July 3, 2010******Net Sales and Gross Margin***

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
	(in thousands)			
Net sales	\$ 84,268	\$ 53,188	\$ 171,246	\$ 109,479

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Cost of sales	55,854	34,791	112,416	71,275
Gross profit	\$ 28,414	\$ 18,397	\$ 58,830	\$ 38,204
Gross margin	33.7%	34.6%	34.4%	34.9%

Net sales increased \$31.1 million or 58.4% for Q2 2011, compared to Q2 2010. Excluding the WAG acquisition and the change in the Company's revenue recognition in Q2 2010, net sales increased \$4.3 million or 7.8% primarily due to a \$2.6 million or 6.0% increase in e-commerce sales and a \$0.6 million or 8.2% increase in online marketplace sales. Our e-commerce

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channel includes a network of e-commerce websites, supported by our call-center sales agents who generate cross-sell and up-sell opportunities. We also sell our products through our online marketplaces, which primarily consist of auction and other third-party websites. The increase in e-commerce sales for Q2 2011, compared to Q2 2010, resulted from a 9% increase in unique visitors, a 1% increase in revenue capture, which is the amount of dollars retained by us after taking into consideration any credit card declines, returns and product fulfillment, a 2% decline in average order value, and a 3% decline in conversion. Our conversion rate is the ratio of visitors who convert into placed orders.

Net sales increased \$61.8 million or 56.4% for the twenty-six weeks ended July 2, 2011 ( YTD Q2 2011 ), compared to the twenty-six weeks ended July 3, 2010 ( YTD Q2 2010 ). Excluding the WAG acquisition and the change in the Company's revenue recognition in Q2 2010, net sales increased \$11.8 million or 10.6% primarily due to a \$10.4 million or 12.1% increase in e-commerce sales. The increase in e-commerce sales for YTD Q2 2011, compared to YTD Q2 2010, resulted from a 4% improvement in conversion, an 9% increase in unique visitors, and a 2% increase in revenue capture, partially offset by a 3% decline in average order value.

We have historically experienced seasonality in our business which generally has resulted in higher sales in winter and summer months. We expect seasonality to continue in future years as automobile collisions during inclement weather create increased demand for body parts in winter months, and consumers often undertake projects to maintain and enhance the performance of their automobiles in the summer months. We anticipate that seasonality will continue to have a material impact on our financial condition and results of operations during the reporting periods in any given year.

Gross profit increased \$10.0 million or 54.5% during Q2 2011, compared to Q2 2010. Excluding the WAG acquisition, gross profit increased \$1.8 million or 9.9%. Gross profit increased \$20.6 million or 54.0% during YTD Q2 2011, compared to YTD Q2 2010. Excluding the WAG acquisition, gross profit increased \$4.1 million or 10.7%. The increase in gross profit was primarily due to increased sales across all sales channels except for online marketplaces.

Gross margin decreased 0.9% to 33.7% of net sales during Q2 2011, compared with Q2 2010. Excluding the WAG acquisition, gross margin decreased 0.6% to 34.0% of net sales. Gross margin decreased 0.5% to 34.4% of net sales during YTD Q2 2011, compared with YTD Q2 2010. Excluding the WAG acquisition, gross margin decreased 0.6% to 34.3% of net sales. Gross margin was unfavorably impacted by a mix shift from body to engine parts partially offset by price increases in both body and engine parts.

*Marketing Expense*

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
	(in thousands)			
Marketing expense	\$ 14,366	\$ 7,138	\$ 27,951	\$ 14,351
Percent of net sales	17.0%	13.5%	16.3%	13.1%

Online advertising expense (which includes catalog costs) was \$7.6 million or 9.8% and \$14.7 million or 9.3% of internet and catalog net sales for Q2 2011 and YTD Q2 2011, respectively. Excluding the WAG acquisition, online advertising expense was 7.0% of internet net sales, up 0.7% from Q2 2010, and 6.8% of internet net sales, up 0.3% from YTD Q2 2010. Marketing expense (excluding advertising expense) was \$6.8 million or 8.0% of net sales for Q2 2011, compared to 7.5% in Q2 2010. Excluding the WAG acquisition, marketing expense was \$4.7 million or 7.9% of Q2 2011 net sales, up 0.4% from Q2 2010. Marketing expense was \$13.2 million or 7.7% of net sales for YTD Q2 2011, compared to 7.2% in YTD Q2 2010. Excluding the WAG acquisition, marketing expense was \$9.2 million or 7.5% of YTD Q2 2011 net sales, up 0.3% from YTD Q2 2010. The increase was primarily due to higher amortization from software deployments this year and additional marketing services.



**Table of Contents***General and Administrative Expense*

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
	(in thousands)			
General and administrative expense	\$ 8,407	\$ 6,395	\$ 16,643	\$ 12,132
Percent of net sales	10.0%	12.0%	9.7%	11.1%

General and administrative expense increased \$2.0 million or 31.4% and \$4.5 million or 37.2% in Q2 2011 and YTD Q2 2011, compared to Q2 2010 and YTD Q2 2010, respectively. Excluding the WAG acquisition and the cost to protect our intellectual property, general and administrative expense for Q2 2011 was \$4.8 million or 8.0% of net sales, down 1.7% from Q2 2010, and general and administrative expense for YTD Q2 2011 was \$10.0 million or 8.1% of net sales, down 1.3% from YTD Q2 2010. This decrease reflects fixed cost leverage from higher sales.

*Fulfillment Expense*

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
	(in thousands)			
Fulfillment expense	\$ 4,592	\$ 2,924	\$ 9,599	\$ 6,167
Percent of net sales	5.4%	5.5%	5.6%	5.6%

Fulfillment expense increased \$1.7 million or 57.1% and \$3.4 million or 55.7% in Q2 2011 and YTD Q2 2011, compared to Q2 2010 and YTD Q2 2010, respectively. Excluding the WAG acquisition, Q2 2011 fulfillment expense was \$3.7 million or 6.2% of net sales, up from 5.5% last year, and YTD Q2 2011 fulfillment expense was \$7.6 million or 6.2% of net sales, up from 5.6% last year. The increase is primarily due to higher depreciation and amortization expense from software deployments.

*Technology Expense*

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
	(in thousands)			
Technology expense	\$ 1,917	\$ 1,158	\$ 3,855	\$ 2,176
Percent of net sales	2.3%	2.2%	2.3%	2.1%

Technology expense increased \$0.8 million or 65.5% and \$1.7 million or 77.2% in Q2 2011 and YTD Q2 2011, compared to Q2 2010 and YTD Q2 2010, respectively. Excluding the WAG acquisition, Q2 2011 technology expense was \$1.2 million or 2.0% of net sales, down 0.2%, reflecting fixed cost leverage from higher sales. YTD Q2 2011 technology expense was \$2.5 million representing 2.0% of net sales in both YTD Q2 2011 and YTD Q2 2010.

*Amortization of Intangibles*

Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
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(in thousands)

Amortization of Intangibles	\$ 1,363	\$ 124	\$ 2,990	\$ 245
Percent of net sales	1.6%	0.2%	1.7%	0.2%

Amortization of intangibles increased by \$1.2 million and \$2.7 million for Q2 2011 and YTD Q2 2011, compared to Q2 2010 and YTD Q2 2010, respectively. The increase for both periods was primarily due to the acquisition of WAG's intangible assets and the accelerated amortization of certain intangibles acquired from WAG. Excluding the WAG acquisition, amortization of intangibles was \$0.1 million in Q2 2011 and Q2 2010 and \$0.2 million in YTD Q2 2011 and YTD Q2 2010.

**Table of Contents***Interest (Expense) Income*

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
	(in thousands)			
Interest (expense) income	\$ (185)	\$ 34	\$ (467)	\$ 55

Interest expense increased \$0.2 million and \$0.5 million in Q2 2011 and YTD Q2 2011, compared to Q2 2010 and YTD Q2 2010, respectively, primarily due to the interest on the long-term debt of \$25 million borrowed in August 2010. The outstanding long-term debt was \$21 million at July 2, 2011.

*Income Tax Provision*

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
	(in thousands)			
Income tax provision	\$ 195	\$ 225	\$ 213	\$ 1,175

For Q2 2011 and Q2 2010, our effective tax rate was (8.2)% and 32.8%, respectively. Additionally, for YTD Q2 2011 and YTD Q2 2010, our effective tax rate was (8.2)% and 36.9%, respectively. Our effective tax rate for both periods differed from the U.S. federal statutory rate primarily due to an increase in valuation allowance against pre-tax operating losses and recording of provision for increasing long-term deferred tax liabilities associated with indefinite-lived intangibles which could not be offset with the operating losses. As of July 2, 2011, we had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters.

**Liquidity and Capital Resources***Sources of Liquidity*

During the twenty-six weeks ended July 2, 2011, we funded our operations with cash and cash equivalents generated from operations, credit facilities and capital lease financings. We had cash and cash equivalents of \$16.2 million as of July 2, 2011, representing a \$1.4 million decrease from \$17.6 million of cash and cash equivalents as of January 1, 2011. The decrease in cash and cash equivalents is primarily due to capital expenditures and pay down of long-term debt partially offset by operating cash flows. We had no balance outstanding under our bank line of credit at any time during the twenty-six weeks ended July 2, 2011.

On May 2, 2011, we filed a shelf registration statement covering the offer and sale of up to \$200 million of common stock with the SEC. On August 8, 2011, we filed an amendment to the shelf registration statement filed May 2, 2011 to include language incorporating all Exchange Act filings filed after the date of our initial registration statement filing and prior to effectiveness. We have no immediate plans or current commitments to sell this common stock. The terms of any offering under our shelf registration statement will be determined at the time of the offering and disclosed in a prospectus supplement filed with the SEC.

*Cash Flows*

The following table summarizes the key cash flow metrics from our unaudited condensed consolidated statements of cash flow for the twenty-six weeks ended July 2, 2011 and July 3, 2010, respectively (in thousands):

Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
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Net cash provided by operating activities	7,420	9,317
Net cash used in investing activities	(6,057)	(21,292)
Net cash (used in) provided by financing activities	(2,720)	895
Effect of exchange rate changes on cash	11	26
Net decrease in cash and cash equivalents	(1,346)	(11,054)

### *Operating Activities*

Net cash provided by operating activities decreased by \$1.9 million for the twenty-six weeks ended July 2, 2011, as compared to the twenty-six weeks ended July 3, 2010, largely due to a decrease in cash used for purchase of inventory offset by timing of payments on accounts payable and collection on accounts receivable.

**Table of Contents***Investing Activities*

Net cash flows used in investing activities decreased by \$15.2 million for the twenty-six weeks ended July 2, 2011, as compared to the twenty-six weeks ended July 3, 2010, primarily due to decreased investment in short-term marketable securities.

*Financing Activities*

Net cash used in financing activities increased by \$3.6 million for the twenty-six weeks ended July 2, 2011, as compared to the twenty-six weeks ended July 3, 2010, primarily due to the payment of \$3.0 million made on our long-term debt under our credit facility.

*Funding requirements*

As of July 2, 2011, our working capital was \$18.5 million. The historical seasonality in our business during the fourth and first calendar quarters of each year cause cash and cash equivalents, inventory and accounts payable to be generally higher in these quarters, resulting in fluctuations in our working capital.

In August 2010, we and Silicon Valley Bank ( Bank ) entered into a Loan and Security Agreement (the Loan Agreement ) and other definitive documentation for a \$35 million secured credit facility (the Facility ). The Facility is comprised of a term loan in the original principal amount of \$25 million and a revolving line of credit with availability up to \$10 million. The Facility has a final maturity date of June 30, 2014, and borrowings under the Facility bear interest, at our election, at LIBOR (with a floor of 1.25%) plus a margin of from 2.00% to 3.00% per annum, or at the Wall Street Journal Prime Rate plus a margin of from 1.00% to 2.00% per annum, based upon our maximum funded debt ratio. An unused revolving line fee of 0.375% per annum is payable on the undrawn committed amount of the revolving line of credit. Interest on outstanding borrowings under the term loan and the revolving line of credit is payable no less than quarterly, and the outstanding principal of the term loan amortizes over four years and is payable quarterly, with any outstanding amount under the Facility to be paid in full on the final maturity date. Borrowings under the Facility are secured by liens over all our assets, including shares of stock in each of our subsidiaries. Ten of our subsidiaries are acting as co-borrowers under the Facility. At July 2, 2011, the LIBOR rate and the margin were 1.25% and 2.50% per annum, respectively. We had no borrowings on the revolving line of credit at any time during the twenty-six weeks ended July 2, 2011. The remaining term loan balance was \$21 million as of July 2, 2011 and is to be repaid according to the following schedule (in thousands):

Total	Payments Due by Period			
	2011	2012	2013	2014
\$21,000	\$3,125	\$6,250	\$6,875	\$4,750

The Loan Agreement requires us to comply with a number of covenants, including financial covenants related to maximum funded debt to consolidated EBITDA, liquidity, and consolidated fixed charge coverage ratios; negative pledge requirements; requirements to deliver quarterly and annual consolidated financial statements; requirements to maintain adequate insurances; prohibitions on changes in the business and disposition of our assets; and other customary covenants. The Loan Agreement also requires us to obtain a prior written consent from the Bank when we determine to pay any dividends on or make any distribution related to our common stock. The Loan Agreement includes usual and customary events of default and remedies for facilities of this nature. In February 2011, we and the Bank entered into Amendment No. 1 to Loan and Security Agreement and Limited Waiver ( Amendment ). The Amendment waived our lack of compliance with the consolidated fixed charge coverage ratio covenant in the Loan Agreement as of January 1, 2011. The Amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA to more readily accommodate our integration of the WAG acquisition. For the thirteen and twenty-six weeks ended July 2, 2011, we were in compliance with all covenants under the Facility.

We anticipate that funds generated from operations and cash on hand will be sufficient to meet our working capital needs, expected capital expenditures and the servicing of the debt for at least the next twelve months. Our future capital requirements may, however, vary materially from those now planned or anticipated. Changes in our operating plans, lower than anticipated net sales, additional acquisitions, increased expenses, continued or worsened economic conditions, or other events, including those described in Risk Factors , included in Part II, Item 1A of this report, may cause us to seek debt or equity financings in the future. Financings may not be available on acceptable terms, on a timely basis, or at all, and our failure to raise adequate capital when needed could negatively impact our growth plans and our financial condition and results of operations. As of July 2, 2011, our \$3,766 (fair value in thousands) of ARPS investments remained classified as long-term investments as a result of failed auctions and market liquidity issues. We may not have immediate access to those funds.

We also plan to continue our technology investments in an effort to improve our websites, operating systems, and backend platforms.



**Table of Contents***Debt and Available Borrowing Resources*

Short-term debt increased by \$0.1 million as of July 2, 2011 from that as of January 1, 2011. Long-term debt decreased by \$3.2 million as of July 2, 2011 from that as of January 1, 2011. The net decrease was primarily due to the \$3 million payment made on our long-term debt under the credit facility during the twenty-six weeks ended July 2, 2011.

Our debt-equity ratio was calculated as the carrying value of debt divided by the carrying value of equity. As of July 2, 2011 and January 1, 2011, our debt-equity ratio was 0.30 and 0.33, respectively, due to borrowings under our credit facility.

As of July 2, 2011, an unused revolving line of credit with availability up to \$10 million was available to us to obtain short-term and long-term financings if we need additional liquidity.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

**Contractual Obligations**

The following table sets forth our contractual cash obligations and commercial commitments as of July 2, 2011 (in thousands):

Contractual Obligations:	Total	Payment Due By Period			Thereafter
		2011	2012-2013	2014-2015	
Principal payments on long-term debt <sup>(1)</sup>	21,000	3,125	13,125	4,750	
Interest payments on long-term debt <sup>(2)</sup>	1,384	379	928	77	
Operating lease obligations <sup>(3)</sup>	6,871	830	2,997	2,292	752
Capital lease obligations <sup>(4)</sup>	252	93	159		

(1) Amounts represent the expected principal cash payments relating to our long-term debt and do not include any fair value adjustments or discounts and premiums.

(2) Amounts represent the expected interest cash payments relating to our long-term debt. The interest rate at July 2, 2011 was used to calculate the expected future interest payments.

(3) Commitments under operating leases relate primarily to our lease on our principal facility in Carson, California, our distribution center in Chesapeake, Virginia, and our call center in the Philippines. The leases on WAG's office in Chicago and warehouse space in LaSalle, Illinois and Independence, Ohio are also included.

(4) Commitments under capital leases relate to equipment lease agreements.

**Seasonality**

We believe our business is subject to seasonal fluctuations. We have historically experienced higher sales of body parts in winter months when inclement weather and hazardous road conditions typically result in more automobile collisions. Engine parts and performance parts and accessories have historically experienced higher sales in the summer months when consumers have more time to undertake elective projects to maintain and enhance the performance of their automobiles and the warmer weather during that time is conducive for such projects. We expect the historical seasonality trends to continue to have a material impact on our financial condition and results of operations during the reporting periods in any given years.

**Inflation**

Inflation has not had a material impact upon our operating results, and we do not expect it to have such an impact in the near future. We cannot assure you that our business will not be affected by inflation in the future.

**ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

*Market Risk.* Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial commodity market prices and rates. We are exposed to market risk primarily in the area of changes in U.S. interest rates and conditions in the credit markets. We also have some exposure related to foreign currency fluctuations. We do not have derivative financial instruments. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We attempt to increase the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities and mutual funds that hold debt securities.



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*Interest Rate Risk.* Our investment securities generally consist of high-grade auction rate preferred securities. As of July 2, 2011, our long-term investments included \$3.8 million (fair value) of investments in ARPS, which consisted of high-grade (A or AAA rated) collateralized debt obligations issued by municipalities and state agencies. Our ARPS have an interest rate that is reset in short intervals through auctions. The current conditions in the global credit markets have prevented some investors from liquidating their holdings of ARPS because the amount of securities submitted for sale has exceeded the amount of purchase orders for these securities. If there is insufficient demand for the securities at the time of an auction, the auction may not be completed and the interest rates may be reset to predetermined higher rates. When auctions for these securities fail, the investments may not be readily convertible to cash until a future auction of these investments is successful or they are redeemed or mature. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an impairment charge.

In February 2008, we were informed that there was insufficient demand at auctions for four of our high-grade ARPS, representing approximately \$7.8 million. As a result, these affected securities are currently not liquid and the interest rates have been reset to the predetermined higher rates. For the period between June 30, 2008 through July 2, 2011, we received partial redemptions at par on all four ARPS totaling \$3.9 million. The remaining principal balance on our ARPS was \$3.8 million as of July 2, 2011.

In the event we need to access the funds that are in an illiquid state, we will not be able to do so without the possible loss of principal until a future auction for these investments is successful or they are redeemed by the issuer. At this time, management has not obtained sufficient evidence to conclude that these investments are other-than-temporarily impaired or that they will not be settled in the short term, although the market for these investments is presently uncertain. If we are unable to sell these securities in the market or they are not redeemed, then we may be required to hold them indefinitely. We do not expect to have a need to access these funds for operational purposes for the foreseeable future. We plan to continue to monitor and evaluate these investments on an ongoing basis for impairment. Based on our ability to access our cash and other short-term investments, our expected cash flows, and our other sources of cash, we do not anticipate that the potential illiquidity of these investments will affect our ability to execute our current business plan. However, due to the illiquidity in the market, we have recorded \$0.1 million of unrealized losses on our investment portfolio as of July 2, 2011.

As of July 2, 2011, we had a balance of \$21.0 million outstanding under a term loan under our credit facility with Silicon Valley Bank. The interest rate on this loan is computed at a LIBOR loan rate, adjusted by features specified in our loan agreements. At our current debt level as of July 2, 2011, a 100 basis point increase in interest rates would not materially affect our earnings and cash flows. If, however, we are unable to meet the covenants in our loan agreement, we would be required to renegotiate the terms of credit under the loan agreement, including the interest rate. There can be no assurance that any renegotiated terms of credit would not materially impact our earnings. As of January 1, 2011, our consolidated fixed charge coverage ratio was lower than the ratio required by the covenants in the Loan and Security Agreement between us and Silicon Valley Bank. The bank has granted an amendment and limited waiver, which will not impact operating flexibility going forward. As of July 2, 2011, we were in compliance with all covenants under the credit facility.

*Foreign Currency Risk.* Our purchases of auto parts from our Asian suppliers are denominated in U.S. Dollars; however, a change in the foreign currency exchange rates could impact our product costs over time. Our financial reporting currency is the U.S. Dollar and changes in exchange rates significantly affect our reported results and consolidated trends. For example, if the U.S. Dollar weakens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit, and operating expenses will be higher than if currencies had remained constant. Likewise, if the U.S. Dollar strengthens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit and operating expenses will be lower than if currencies had remained constant. Our operating expenses in the Philippines are generally paid in Philippine Pesos, and as the exchange rate fluctuates, it adversely or favorably impacts our operating results. In light of the above, we believe that a fluctuation of 10% in the Peso/U.S. Dollar exchange rate would have had approximately a \$0.6 million impact on our operating expenses for the twenty-six weeks ended July 2, 2011. Our Canadian website sales are denominated in Canadian Dollars; however, fluctuations in exchange rates from these operations are only expected to have a nominal impact on our operating results due to the relatively small number of sales generated in Canada. We believe it is important to evaluate our operating results and growth rates before and after the effect of currency changes.

#### **ITEM 4. Controls and Procedures** **Evaluation of Disclosure Controls and Procedures**

We carried out an evaluation required by Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the 1934 Act), under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the 1934 Act, as of the end of the period covered by this report.



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Disclosure controls and procedures provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Based on this evaluation, our CEO and CFO have concluded that, as of such date, our disclosure controls and procedures were effective to meet the objectives for which they were designed.

### **Changes in Internal Control Over Financial Reporting**

During the most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

### **Inherent Limitations on Internal Controls**

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

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**PART II. Other Information**

**ITEM 1. Legal Proceedings**

The information set forth under *Note 13 Contingencies* of the Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report, is incorporated herein by reference.

**ITEM 1A. Risk Factors**

*Our business is subject to a number of risks which are discussed below. Other risks are presented elsewhere in this report and in our other filings with the SEC. We have marked with an asterisk (\*) those risk factors that reflect substantive changes from the risk factors included in the Annual Report on Form 10-K that we filed with the SEC on March 17, 2011. You should consider carefully the following risks in addition to the other information contained in this report and our other filings with the SEC, including our report on Form 10-K and our subsequent reports on Forms 10-Q and 8-K, and amendments thereto, before deciding to buy, sell or hold our common stock. If any of the following known or unknown risks or uncertainties actually occurs with material adverse effects on us, our business, financial condition, results of operations and/or liquidity could be seriously harmed. In that event, the market price for our common stock will likely decline and you may lose all or part of your investment.*

**Risks Related To Our Business**

*Purchasers of aftermarket auto parts may not choose to shop online, which would prevent us from acquiring new customers who are necessary to the growth of our business.*

The online market for aftermarket auto parts is less developed than the online market for many other business and consumer products, and currently represents only a small part. Our success will depend in part on our ability to attract new customers and to convert customers who have historically purchased auto parts through traditional retail and wholesale operations. Furthermore, we may have to incur significantly higher and more sustained advertising and marketing expenditures or may need to price our products more competitively than we currently anticipate in order to attract additional online consumers and convert them into purchasing customers. Specific factors that could prevent prospective customers from purchasing from us include:

concerns about buying auto parts without face-to-face interaction with sales personnel;

the inability to physically handle, examine and compare products;

delivery time associated with Internet orders;

concerns about the security of online transactions and the privacy of personal information;

delayed shipments or shipments of incorrect or damaged products;

increased shipping costs; and

the inconvenience associated with returning or exchanging items purchased online.

If the online market for auto parts does not gain widespread acceptance, our sales may decline and our business and financial results may suffer.

***We depend on search engines and other online sources to attract visitors to our websites, and if we are unable to attract these visitors and convert them into customers in a cost-effective manner, our business and results of operations will be harmed.***

Our success depends on our ability to attract online consumers to our websites and convert them into customers in a cost-effective manner. We are significantly dependent upon search engines, shopping comparison sites and other online sources for our website traffic. We are included in search results as a result of both paid search listings, where we purchase specific search terms that will result in the inclusion of our listing, and algorithmic searches that depend upon the searchable content on our sites. Algorithmic listings cannot be purchased and instead are determined and displayed solely by a set of formulas utilized by the search engine. Search engines, shopping comparison sites and other online sources revise their algorithms from time to time in an attempt to optimize their search results. If one or more of the search engines, shopping comparison sites or other online sources on which we rely for website traffic were to modify its general methodology for how it displays or selects our websites, it could result in fewer consumers clicking through to our websites, and our financial results could be adversely affected. We operate a multiple website platform that generally allows us to provide multiple search results for a particular algorithmic search. If the search engines were to limit our display results to a single result or entirely eliminate our results from the algorithmic search, our website traffic would significantly decrease and our business would be materially harmed. If any free search engine or shopping comparison site on which we rely begins charging fees for listing or placement, or if one or more of the search engines, shopping comparison sites and other online sources on which we rely for purchased listings, modifies or terminates its relationship with us, our expenses could rise, we could lose customers and traffic to our websites could decrease. In addition, our success in attracting visitors who convert to customers will depend in part upon our ability to identify and purchase relevant search terms, provide relevant content on our sites, and effectively

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target our other marketing programs such as e-mail campaigns and affiliate programs. If we are unable to attract visitors to our websites and convert them to customers in a cost-effective manner, then our sales may decline and our business and financial results may be harmed.

*\* Future acquisitions could disrupt our business and harm our financial condition.*

As part of our growth strategy, we acquired WAG on August 12, 2010 and we expect that we will selectively pursue additional acquisitions of businesses, technologies or services in order to expand our capabilities, enter new markets or increase our market share. In conjunction with the acquisition of WAG, we recorded a significant valuation allowance against our deferred tax asset, and have incurred greater than usual legal and accounting fees, as well as general and administrative expenses. Additionally, because the acquisition of WAG was a stock purchase, we may incur liability for acts taken prior to our acquisition that may involve costly litigation. Integrating any newly acquired businesses' websites, technologies or services is likely to be expensive and time consuming. For example, our acquisition of All OEM Parts, Inc., the Partsbin.com, Inc., and other affiliated companies (collectively "Partsbin"), resulted in significant costs, including a material impairment charge, a write-down of goodwill associated with the acquisition, and a number of challenges, including retaining employees of the acquired company, integrating our order processing and credit processing, integrating our product pricing strategy, and integrating the diverse technologies and differing e-commerce platforms and accounting systems used by each company. Our integration activities in connection with our acquisitions have also caused a substantial diversion of our management's attention. If we are unable to successfully complete the integration of acquisitions, including WAG, we may not realize the anticipated synergies from such acquisitions, we may take impairment charges and write-downs associated with such acquisitions, and our business and results of operations could suffer. In connection with the acquisition of WAG, we have incurred acquisition and integration related costs of \$5.9 million. To finance any future acquisitions, it may also be necessary for us to raise additional capital through public or private financings or to obtain additional bank financing. Additional funds may not be available on terms that are favorable to us, and, in the case of equity financings, would result in dilution to our stockholders. Future acquisitions by us could also result in assumption of debt and unforeseen liabilities (including our becoming involved in litigation relating to any business we acquire) and significant adverse accounting charges, any of which could substantially harm our business, financial condition and results of operations.

*We may not be able to successfully acquire new businesses or integrate acquisitions, which could cause our business to suffer.*

We may not be able to successfully complete potential strategic acquisitions if we cannot reach agreement on acceptable terms or for other reasons. If we buy a company or a division of a company, we may experience difficulty integrating that company's or division's personnel and operations, which could negatively affect our operating results. In addition:

the key personnel of the acquired company may decide not to work for us;

customers of the acquired company may decide not to purchase products from us;

we may experience business disruptions as a result of information technology systems conversions;

we may experience additional financial and accounting challenges and complexities in areas such as tax planning, treasury management, and financial reporting;

we may be held liable for environmental, tax or other risks and liabilities as a result of our acquisitions, some of which we may not have discovered during our due diligence;

we may intentionally assume the liabilities of the companies we acquire, which could materially and adversely affect our business;

our ongoing business may be disrupted or receive insufficient management attention;

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we may not be able to realize the cost savings or other financial benefits or synergies we anticipated, either in the amount or in the time frame that we expect; and

we may incur debt or issue equity securities to pay for any future acquisition, the issuance of which could involve the imposition of restrictive covenants or be dilutive to our existing stockholders.

***Our operations are restricted by our credit facility.***

Our credit facility includes a number of restrictive covenants. These covenants could impair our financing and operational flexibility and make it difficult for us to react to market conditions and satisfy our ongoing capital needs and unanticipated cash requirements. Specifically, such covenants restrict our ability and, if applicable, the ability of our subsidiaries to, among other things:

incur additional debt;

make certain investments and acquisitions;

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enter into certain types of transactions with affiliates;

use assets as security in other transactions;

pay dividends on our capital stock or repurchase our equity interests;

sell certain assets or merge with or into other companies;

guarantee the debts of others;

enter into new lines of business;

pay or amend our subordinated debt; and,

form any joint ventures or subsidiary investments.

In addition, our current credit facility requires us to satisfy certain financial covenants. These financial covenants and tests could limit our ability to react to market conditions or satisfy extraordinary capital needs and could otherwise restrict our financing and operations.

Our ability to comply with the covenants and other terms of our debt obligations will depend on our future operating performance. If we fail to comply with such covenants and terms, we would be required to obtain waivers from our lenders to maintain compliance with our debt obligations. As of January 1, 2011, in connection with our credit facility, our consolidated fixed charge coverage ratio was lower than the ratio required by the covenants in the credit facility. In February 2011, we and the Bank, entered into an amendment to our credit facility that waived our non compliance with the consolidated fixed charge coverage ratio covenant in the credit facility. The amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA (earnings before income tax, depreciation and amortization) to more readily accommodate our integration of the WAG acquisition. If we are unable to obtain any necessary waivers and the debt is accelerated, a material adverse effect on our financial condition and future operating performance would result. Additionally, our indebtedness could have important consequences, including the following:

We will have to dedicate a portion of our cash flow to making interest and principal payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions or other general corporate purposes.

Certain levels of indebtedness may make us less attractive to potential acquirers or acquisition targets.

Certain levels of indebtedness may limit our flexibility to adjust to changing business and market conditions, and make us more vulnerable to downturns in general economic conditions as compared to competitors that may be less leveraged.

As described in more detail above, the documents providing for our indebtedness contain restrictive covenants that may limit our financing and operational flexibility.

Furthermore, our ability to satisfy our debt service obligations will depend, among other things, upon fluctuations in interest rates, our future operating performance and ability to refinance indebtedness when and if necessary. These factors depend partly on economic, financial, competitive and other factors beyond our control. We may not be able to generate sufficient cash from operations to meet our debt service



obligations as well as fund necessary capital expenditures and general operating expenses. In addition, if we need to refinance our debt, or obtain additional financing or sell assets or equity to satisfy our debt service obligations, we may not be able to do so on commercially reasonable terms, if at all.

***If we are unable to manage the challenges associated with our international operations, the growth of our business could be limited and our business could suffer.***

We maintain business operations in the United States and the Philippines. These international operations include development and maintenance of our websites, Internet marketing personnel, and sales and customer support services. We also operate a Canadian subsidiary to facilitate sales in Canada. We are subject to a number of risks and challenges that specifically relate to our international operations. Our international operations may not be successful if we are unable to meet and overcome these challenges, which could limit the growth of our business and may have an adverse effect on our business and operating results. These risks and challenges include:

the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our business, operations and infrastructure;

difficulties and costs of staffing and managing foreign operations;

restrictions imposed by local labor practices and laws on our business and operations;

exposure to different business practices and legal standards;

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unexpected changes in regulatory requirements;

the imposition of government controls and restrictions;

political, social and economic instability and the risk of war, terrorist activities or other international incidents;

the failure of telecommunications and connectivity infrastructure;

natural disasters and public health emergencies;

potentially adverse tax consequences;

the failure of local laws to provide a sufficient degree of protection against infringement of our intellectual property; and

fluctuations in foreign currency exchange rates and relative weakness in the U.S. Dollar.

***\*We are dependent upon relationships with suppliers in Taiwan, China and the United States for the vast majority of our products.***

We acquire substantially all of our products from manufacturers and distributors located in Taiwan, China and the United States. Our top ten suppliers represented approximately 55.1% of our total product purchases during the twenty-six weeks ended July 2, 2011. We do not have any long-term contracts or exclusive agreements with our foreign suppliers that would ensure our ability to acquire the types and quantities of products we desire at acceptable prices and in a timely manner. In addition, our ability to acquire products from our suppliers in amounts and on terms acceptable to us is dependent upon a number of factors that could affect our suppliers and which are beyond our control. For example, financial or operational difficulties that some of our suppliers may face could result in an increase in the cost of the products we purchase from them. In addition, the increasing consolidation among auto parts suppliers may disrupt or end our relationship with some suppliers, result in product shortages and/or lead to less competition and, consequently, higher prices.

In addition, because many of our suppliers are outside of the United States, additional factors could interrupt our relationships or affect our ability to acquire the necessary products on acceptable terms, including:

political, social and economic instability and the risk of war or other international incidents in Asia or abroad;

fluctuations in foreign currency exchange rates that may increase our cost of products;

tariffs and protectionist laws and business practices that favor local businesses;

difficulties in complying with import and export laws, regulatory requirements and restrictions; and

natural disasters and public health emergencies.

If we do not maintain our relationships with our existing suppliers or develop relationships with new suppliers on acceptable commercial terms, we may not be able to continue to offer a broad selection of merchandise at competitive prices and, as a result, we could lose customers and our sales could decline.

***\*We are dependent upon third parties for distribution and fulfillment operations with respect to many of our products.***

For a number of the products that we sell, we outsource the distribution and fulfillment operation and are dependent on our distributors to manage inventory, process orders and distribute those products to our customers in a timely manner. For the twenty-six weeks ended July 2, 2011, our product purchases from a single supplier represented 16.4% of our total product purchases. If we do not maintain our existing relationships with this supplier and our other distributors on acceptable commercial terms, we will need to obtain other suppliers and may not be able to continue to offer a broad selection of merchandise at competitive prices, and our sales may decrease.

In addition, because we outsource to distributors a number of these traditional retail functions relating to those products, we have limited control over how and when orders are fulfilled. We also have limited control over the products that our distributors purchase or keep in stock. Our distributors may not accurately forecast the products that will be in high demand or they may allocate popular products to other resellers, resulting in the unavailability of certain products for delivery to our customers. Any inability to offer a broad array of products at competitive prices and any failure to deliver those products to our customers in a timely and accurate manner may damage our reputation and brand and could cause us to lose customers.

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***We depend on third-party delivery services to deliver our products to our customers on a timely and consistent basis, and any deterioration in our relationship with any one of these third parties or increases in the fees that they charge could harm our reputation and adversely affect our business and financial condition.***

We rely on third parties for the shipment of our products and we cannot be sure that these relationships will continue on terms favorable to us, or at all. Shipping costs have increased from time to time, and may continue to increase, which could harm our business, prospects, financial condition and results of operations by increasing our costs of doing business and resulting in reduced gross margins. In addition, if our relationships with these third parties are terminated or impaired, or if these third parties are unable to deliver products for us, whether due to labor shortage, slow down or stoppage, deteriorating financial or business condition, responses to terrorist attacks or for any other reason, we would be required to use alternative carriers for the shipment of products to our customers. Changing carriers could have a negative effect on our business and operating results due to reduced visibility of order status and package tracking and delays in order processing and product delivery, and we may be unable to engage alternative carriers on a timely basis, upon terms favorable to us, or at all.

***If commodity prices such as fuel, plastic and steel continue to increase, our margins may shrink.***

Our third party delivery services have increased fuel surcharges from time to time, and such increases negatively impact our margins, as we are generally unable to pass all of these costs directly to consumers. Increasing prices in the component materials for the parts we sell may impact the availability, the quality and the price of our products, as suppliers search for alternatives to existing materials and as they increase the prices they charge. We cannot ensure that we can recover all the increased costs through price increases, and our suppliers may not continue to provide the consistent quality of product as they may substitute lower cost materials to maintain pricing levels, all of which may have a negative impact on our business and results of operations.

***If our fulfillment operations are interrupted for any significant period of time or are not sufficient to accommodate increased demand, our sales would decline and our reputation could be harmed.***

Our success depends on our ability to successfully receive and fulfill orders and to promptly deliver our products to our customers. The majority of orders for our auto body parts products are filled from our inventory in our distribution centers, where all our inventory management, packaging, labeling and product return processes are performed. Increased demand and other considerations may require us to expand our distribution centers or transfer our fulfillment operations to larger facilities in the future.

Our distribution centers are susceptible to damage or interruption from human error, fire, flood, power loss, telecommunications failures, terrorist attacks, acts of war, break-ins, earthquakes and similar events. We do not currently maintain back-up power systems at our fulfillment centers. We do not presently have a formal disaster recovery plan and our business interruption insurance may be insufficient to compensate us for losses that may occur in the event operations at our fulfillment center are interrupted. Any interruptions in our fulfillment operations for any significant period of time, including interruptions resulting from the expansion of our existing facilities or the transfer of operations to a new facility, could damage our reputation and brand and substantially harm our business and results of operations and alternate arrangements may increase the cost of fulfillment. In addition, if we do not successfully expand our fulfillment capabilities in response to increases in demand, we may not be able to substantially increase our net sales.

***We rely on bandwidth and data center providers and other third parties to provide products to our customers, and any failure or interruption in the services provided by these third parties could disrupt our business and cause us to lose customers.***

We rely on third-party vendors, including data center and bandwidth providers. Any disruption in the network access or co-location services, which are the services that house and provide Internet access to our servers, provided by these third-party providers or any failure of these third-party providers to handle current or higher volumes of use could significantly harm our business. Any financial or other difficulties our providers face may have negative effects on our business, the nature and extent of which we cannot predict. We exercise little control over these third-party vendors, which increases our vulnerability to problems with the services they provide. We also license technology and related databases from third parties to facilitate elements of our e-commerce platform. We have experienced and expect to continue to experience interruptions and delays in service and availability for these elements. Any errors, failures, interruptions or delays experienced in connection with these third-party technologies could negatively impact our relationship with our customers and adversely affect our business.

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Our systems also heavily depend on the availability of electricity, which also comes from third-party providers. If we were to experience a major power outage, we would have to rely on back-up generators. These back-up generators may not operate properly through a major power outage, and their fuel supply could also be inadequate during a major power outage. Information systems such as ours may be disrupted by even brief power outages, or by the fluctuations in power resulting from switches to and from backup generators. This could disrupt our business and cause us to lose customers.

***We face intense competition and operate in an industry with limited barriers to entry, and some of our competitors may have greater resources than us and may be better positioned to capitalize on the growing e-commerce auto parts market.***

The auto parts industry is competitive and highly fragmented, with products distributed through multi-tiered and overlapping channels. We compete with both online and offline retailers who offer OEM and aftermarket auto parts to either the do-it-yourself or do-it-for-me customer segments. Current or potential competitors include the following:

national auto parts retailers such as Advance Auto Parts, AutoZone, Napa Auto Parts, CarQuest, O'Reilly Automotive and Pep Boys;

large online marketplaces such as Amazon.com and eBay;

other online retailers;

local independent retailers or niche auto parts online retailers; and

wholesale aftermarket auto parts distributors such as LKQ Corporation.

Barriers to entry are low, and current and new competitors can launch websites at a relatively low cost. Many of our current and potential offline competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing, technical, management and other resources than we do. In addition, some of our competitors have used and may continue to use aggressive pricing tactics and devote substantially more financial resources to website and system development than we do. We expect that competition will further intensify in the future as Internet use and online commerce continue to grow worldwide. Increased competition may result in reduced sales, lower operating margins, reduced profitability, loss of market share and diminished brand recognition.

We would also experience significant competitive pressure if any of our suppliers were to sell their products directly to customers. Since our suppliers have access to merchandise at very low costs, they could sell products at lower prices and maintain higher gross margins on their product sales than we can. In this event, our current and potential customers may decide to purchase directly from these suppliers. Increased competition from any supplier capable of maintaining high sales volumes and acquiring products at lower prices than us could significantly reduce our market share and adversely impact our financial results.

***If we fail to offer a broad selection of products at competitive prices to meet our customers' demands, our revenue could decline.***

In order to expand our business, we must successfully offer, on a continuous basis, a broad selection of auto parts that meet the needs of our customers. Our auto parts are used by consumers for a variety of purposes, including repair, performance, improved aesthetics and functionality. In addition, to be successful, our product offerings must be broad and deep in scope, competitively priced, well-made, innovative and attractive to a wide range of consumers. We cannot predict with certainty that we will be successful in offering products that meet all of these requirements. If our product offerings fail to satisfy our customers' requirements or respond to changes in customer preferences, our revenue could decline.

**Table of Contents*****Challenges by Original Equipment Manufacturers ( OEMs ) to the validity of the aftermarket auto parts industry and claims of intellectual property infringement could adversely affect our business and the viability of the aftermarket auto parts industry.***

Original equipment manufacturers have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEMs have brought such claims in federal court and with the United States International Trade Commission. We have received in the past, and we anticipate we may in the future receive, communications alleging that certain products we sell infringe the patents, copyrights, trademarks and trade names or other intellectual property rights of OEMs or other third parties. For instance, after the three and a half years of litigation and related costs and expenses, on April 16, 2009, we entered into a settlement agreement with Ford Motor Company and Ford Global Technologies, LLC that ended the two legal actions that were initiated by Ford against us. The United States Patent and Trademark Office records indicate that OEMs are seeking and obtaining more design patents than they have in the past. To the extent that the OEMs are successful with intellectual property infringement claims, we could be restricted or prohibited from selling certain aftermarket products which could have an adverse effect on our business. Infringement claims could also result in increased costs of doing business arising from increased legal expenses, adverse judgments or settlements or changes to our business practices required to settle such claims or satisfy any judgments. Litigation could result in interpretations of the law that require us to change our business practices or otherwise increase our costs and harm our business. We do not maintain insurance coverage to cover the types of claims that could be asserted. If a successful claim were brought against us, it could expose us to significant liability.

***If we are unable to protect our intellectual property rights, our reputation and brand could be impaired and we could lose customers.***

We regard our trademarks, trade secrets and similar intellectual property such as our proprietary back-end order processing and fulfillment code and process as important to our success. We rely on trademark and copyright law, and trade secret protection, and confidentiality and/or license agreements with employees, customers, partners and others to protect our proprietary rights. We cannot be certain that we have taken adequate steps to protect our proprietary rights, especially in countries where the laws may not protect our rights as fully as in the United States. In addition, our proprietary rights may be infringed or misappropriated, and we could be required to incur significant expenses to preserve them. For instance, on June 25, 2009, we filed a lawsuit in United States District Court, Central District of California against PartsGeek LLC, its members and several of its employees, alleging, among other things, misappropriation of trade secrets, breach of contract and unfair competition. We are requesting both monetary and injunctive relief. The outcome of such litigation is uncertain, and the cost of prosecuting the litigation may have an adverse impact on our earnings. We have common law trademarks, as well as pending federal trademark registrations for several marks and three registered marks. Even if we obtain approval of such pending registrations, the resulting registrations may not adequately cover our intellectual property or protect us against infringement by others. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our products and services may be made available online. We also currently own or control a number of Internet domain names, including [www.usautoparts.net](http://www.usautoparts.net), [www.autopartswarehouse.com](http://www.autopartswarehouse.com), [www.partstrain.com](http://www.partstrain.com), [www.jcwhitney.com](http://www.jcwhitney.com), and [www.stylintrucks.com](http://www.stylintrucks.com), and have invested time and money in the purchase of domain names and other intellectual property, which may be impaired if we cannot protect such intellectual property. We may be unable to protect these domain names or acquire or maintain relevant domain names in the United States and in other countries. If we are not able to protect our trademarks, domain names or other intellectual property, we may experience difficulties in achieving and maintaining brand recognition and customer loyalty.

***If our product catalog database is stolen, misappropriated or damaged, or if a competitor is able to create a substantially similar catalog without infringing our rights, then we may lose an important competitive advantage.***

We have invested significant resources and time to build and maintain our product catalog, which is maintained in the form of an electronic database, which maps SKUs to relevant product applications based on vehicle makes, models and years. We believe that our product catalog provides us with an important competitive advantage in both driving traffic to our websites and converting that traffic to revenue by enabling customers to quickly locate the products they require. We cannot assure you that we will be able to protect our product catalog from unauthorized copying or theft or that our product catalog will continue to operate adequately, without any technological challenges. In addition, it is possible that a competitor could develop a catalog or database that is similar to or more comprehensive than ours, without infringing our rights. In the event our product catalog is damaged or is stolen, copied or otherwise replicated to compete with us, whether lawfully or not, we may lose an important competitive advantage and our business could be harmed.

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### ***Our e-commerce system is dependent on open-source software, which exposes us to uncertainty and potential liability.***

We utilize open-source software such as Linux, Apache, MySQL, PHP, Fedora and Perl throughout our web properties and supporting infrastructure although we have created proprietary programs. Open-source software is maintained and upgraded by a general community of software developers under various open-source licenses, including the GNU General Public License ( GPL ). These developers are under no obligation to maintain, enhance or provide any fixes or updates to this software in the future. Additionally, under the terms of the GPL and other open-source licenses, we may be forced to release to the public source-code internally developed by us pursuant to such licenses. Furthermore, if any of these developers contribute any code of others to any of the software that we use, we may be exposed to claims and liability for intellectual property infringement. A number of lawsuits are currently pending against third parties over the ownership rights to the various components within some open-source software that we use. If the outcome of these lawsuits is unfavorable, we may be held liable for intellectual property infringement based on our use of these open-source software components. We may also be forced to implement changes to the code-base for this software or replace this software with internally developed or commercially licensed software.

### ***We face exposure to product liability lawsuits.***

The automotive industry in general has been subject to a large number of product liability claims due to the nature of personal injuries that result from car accidents or malfunctions. As a distributor of auto parts, including parts obtained overseas, we could be held liable for the injury or damage caused if the products we sell are defective or malfunction. While we carry insurance against product liability claims, if the damages in any given action were high or we were subject to multiple lawsuits, the damages and costs could exceed the limits of our insurance coverage. If we were required to pay substantial damages as a result of these lawsuits, it may seriously harm our business and financial condition. Even defending against unsuccessful claims could cause us to incur significant expenses and result in a diversion of management's attention. In addition, even if the money damages themselves did not cause substantial harm to our business, the damage to our reputation and the brands offered on our websites could adversely affect our future reputation and our brand, and could result in a decline in our net sales and profitability.

### ***We rely on key personnel and may need additional personnel for the success and growth of our business.***

Our business is largely dependent on the personal efforts and abilities of highly skilled executive, technical, managerial, merchandising, marketing, and call center personnel. Competition for such personnel is intense, and we cannot assure you that we will be successful in attracting and retaining such personnel. The loss of any key employee or our inability to attract or retain other qualified employees could harm our business and results of operations.

### ***System failures, including failures due to natural disasters or other catastrophic events, could prevent access to our websites, which could reduce our net sales and harm our reputation.***

Our sales would decline and we could lose existing or potential customers if they are not able to access our websites or if our websites, transactions processing systems or network infrastructure do not perform to our customers' satisfaction. Any Internet network interruptions or problems with our websites could:

prevent customers from accessing our websites;

reduce our ability to fulfill orders or bill customers;

reduce the number of products that we sell;

cause customer dissatisfaction; or

damage our brand and reputation.

## Edgar Filing: U.S. Auto Parts Network, Inc. - Form 10-Q

We have experienced brief computer system interruptions in the past, and we believe they will continue to occur from time to time in the future. Our systems and operations are also vulnerable to damage or interruption from a number of sources, including a natural disaster or other catastrophic event such as an earthquake, typhoon, volcanic eruption, fire, flood, terrorist attack, computer viruses, power loss, telecommunications failure, physical and electronic break-ins and other similar events. For example, our headquarters and the majority of our infrastructure, including some of our servers, are located in Southern California, a seismically active region. We also maintain offshore and outsourced operations in the Philippines, an area that has been subjected to a typhoon and a volcanic eruption in the past. In addition, California has in the past experienced power outages as a result of limited electrical power supplies and due to recent fires in the southern part of the state. Such outages, natural disasters and similar events may recur in the future and could disrupt the operation of our business. Our technology infrastructure is also vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. Although the critical portions of our systems are redundant and backup copies are maintained offsite, not all of our systems and data are fully redundant. We do not presently have a formal disaster recovery plan in effect and may not have sufficient insurance for losses that may occur from natural disasters or catastrophic events. Any substantial disruption of our technology infrastructure could cause interruptions or delays in our business and loss of data or render us unable to accept and fulfill customer orders or operate our websites in a timely manner, or at all.



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**Risks Related To Our Common Stock**

*Our stock price has been and may continue to be volatile, which may result in losses to our stockholders.*

The market prices of technology and e-commerce companies generally have been extremely volatile and have recently experienced sharp share price and trading volume changes. The trading price of our common stock is likely to be volatile and could fluctuate widely in response to, among other things, the risk factors described in this report and other factors beyond our control such as fluctuations in the operations or valuations of companies perceived by investors to be comparable to us, our ability to meet analysts' expectations, or conditions or trends in the Internet or auto parts industries.

Since the completion of our initial public offering in February 2007, the trading price of our common stock has been volatile, ranging from a high of \$12.61 per share to a low per share of \$1.00. We have also experienced significant fluctuations in the trading volume of our common stock. General economic and political conditions unrelated to our performance may also adversely affect the price of our common stock. In the past, following periods of volatility in the market price of a public company's securities, securities class action litigation has often been initiated. Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of any such litigation if it were initiated. The initiation of any such litigation or an unfavorable result could have a material adverse effect on our financial condition and results of operation.

*\*Our executive officers and directors own a significant percentage of our stock.*

As of July 2, 2011, our executive officers and directors and entities that are affiliated with them beneficially owned in the aggregate approximately 45.6% of our outstanding shares of common stock. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. Also, these stockholders, acting together, will be able to significantly influence our management and affairs and matters requiring stockholder approval including the election of our entire Board of Directors and certain significant corporate actions such as mergers, consolidations or the sale of substantially all of our assets. As a result, this concentration of ownership could delay, defer or prevent others from initiating a potential merger, takeover or other change in our control, even if these actions would benefit our other stockholders and us.

*Our future operating results may fluctuate and may fail to meet market expectations.*

We expect that our revenue and operating results will continue to fluctuate from quarter to quarter due to various factors, many of which are beyond our control. If our quarterly revenue or operating results fall below the expectations of investors or securities analysts, the price of our common stock could significantly decline. The factors that could cause our operating results to continue to fluctuate include, but are not limited to:

fluctuations in the demand for aftermarket auto parts;

price competition on the Internet or among offline retailers for auto parts;

our ability to attract visitors to our websites and convert those visitors into customers;

our ability to maintain and expand our supplier and distribution relationships without significant price increases or reduced service levels;

the effects of seasonality on the demand for our products;

our ability to accurately forecast demand for our products, price our products at market rates and maintain appropriate inventory levels;

our ability to build and maintain customer loyalty;

our ability to successfully integrate our acquisitions;

infringement actions that could impact the viability of the auto parts aftermarket or portions thereof;

the success of our brand-building and marketing campaigns;

our ability to accurately project our future revenues, earnings, and results of operations;

government regulations related to use of the Internet for commerce, including the application of existing tax regulations to Internet commerce and changes in tax regulations;

technical difficulties, system downtime or Internet brownouts;

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the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure; and

the impact of adverse economic conditions on retail sales, in general.

*\*If we fail to maintain an effective system of internal control over financial reporting or comply with Section 404 of the Sarbanes-Oxley Act of 2002, we may not be able to accurately report our financial results or prevent fraud, and our stock price could decline.*

While management has concluded that our internal controls over financial reporting were effective as of July 2, 2011, we have in the past, and could in the future, have a material weakness or significant deficiency in our control over financial reporting or fail to comply with Section 404 of the Sarbanes-Oxley Act of 2002. If we fail to properly maintain an effective system of internal control over financial reporting, it could impact our ability to prevent fraud or to issue our financial statements in a timely manner that presents fairly our financial condition and results of operations. The existence of any such deficiencies or weaknesses, even if cured, may also lead to the loss of investor confidence in the reliability of our financial statements, could harm our business and negatively impact the trading price of our common stock. Such deficiencies or material weaknesses may also subject us to lawsuits, investigations and other penalties.

*Our charter documents could deter a takeover effort, which could inhibit your ability to receive an acquisition premium for your shares.*

Provisions in our certificate of incorporation and bylaws could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. Such provisions include the following:

our Board of Directors are authorized, without prior stockholder approval, to create and issue preferred stock which could be used to implement anti-takeover devices;

advance notice is required for director nominations or for proposals that can be acted upon at stockholder meetings;

our Board of Directors is classified such that not all members of our board are elected at one time, which may make it more difficult for a person who acquires control of a majority of our outstanding voting stock to replace all or a majority of our directors;

stockholder action by written consent is prohibited except with regards to an action that has been approved by the Board;

special meetings of the stockholders are permitted to be called only by the chairman of our Board of Directors, our chief executive officer or by a majority of our Board of Directors;

stockholders are not permitted to cumulate their votes for the election of directors; and

stockholders are permitted to amend certain provisions of our bylaws only upon receiving at least 66<sup>2</sup>/3% of the votes entitled to be cast by holders of all outstanding shares then entitled to vote generally in the election of directors, voting together as a single class.

*We do not intend to pay dividends on our common stock.*

We currently intend to retain any future earnings and do not expect to pay any cash dividends on our capital stock for the foreseeable future.

## **General Market and Industry Risk**

*Economic conditions have had, and may continue to have an adverse effect on the demand for aftermarket auto parts and could adversely affect our sales and operating results.*

We sell aftermarket auto parts consisting of body and engine parts used for repair and maintenance, performance parts used to enhance performance or improve aesthetics and accessories that increase functionality or enhance a vehicle's features. Demand for our products has been and may continue to be adversely affected by general economic conditions. In declining economies, consumers often defer regular vehicle maintenance and may forego purchases of nonessential performance and accessories products, which can result in a decrease in demand for auto parts in general. Consumers also defer purchases of new vehicles, which immediately impacts performance parts and accessories, which are generally purchased in the first six months of a vehicle's lifespan. In addition, during economic downturns some competitors may become more aggressive in their pricing practices, which would adversely impact our gross margin and could cause large fluctuations in our stock price. Certain suppliers may exit the industry which may impact our ability to procure parts and may adversely impact gross margin as the remaining suppliers increase prices to take advantage of limited competition.

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***Vehicle miles driven, vehicle accident rates and insurance companies' willingness to accept a variety of types of replacement parts in the repair process have fluctuated and may decrease, which could result in a decline of our revenues and negatively affect our results of operations.***

We and our industry depend on the number of vehicle miles driven, vehicle accident rates and insurance companies' willingness to accept a variety of types of replacement parts in the repair process. Decreased miles driven reduce the number of accidents and corresponding demand for crash parts, and reduce the wear and tear on vehicles with a corresponding reduction in demand for vehicle repairs and replacement or hard parts, all of which may reduce our revenues and adversely impact our results of operations.

***The success of our business depends on the continued growth of the Internet as a retail marketplace and the related expansion of the Internet infrastructure.***

Our future success depends upon the continued and widespread acceptance and adoption of the Internet as a vehicle to purchase products. If customers or manufacturers are unwilling to use the Internet to conduct business and exchange information, our business will fail. The commercial acceptance and use of the Internet may not continue to develop at historical rates, or may not develop as quickly as we expect. The growth of the Internet, and in turn the growth of our business, may be inhibited by concerns over privacy and security, including concerns regarding viruses and worms, reliability issues arising from outages or damage to Internet infrastructure, delays in development or adoption of new standards and protocols to handle the demands of increased Internet activity, decreased accessibility, increased government regulation, and taxation of Internet activity. In addition, our business growth may be adversely affected if the Internet infrastructure does not keep pace with the growing Internet activity and is unable to support the demands placed upon it, or if there is any delay in the development of enabling technologies and performance improvements.

***\*Negative conditions in the global credit markets may impair the liquidity of a portion of our investments portfolio, and adversely affect our results of operations and access to financing.***

Our investment securities consist of high-grade auction rate preferred securities ( ARPS ). As of July 2, 2011, our long-term marketable securities were comprised of \$3.8 million (par value) of high-grade (AAA rated) ARPS issued primarily by closed end funds that primarily hold debt obligations from municipalities. The recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings, including their holdings of ARPS. In response to the credit situation, in February 2008, we instructed our investment advisor to liquidate all our investments in closed end funds and move these funds into money market investments but there was insufficient demand at auction for our remaining four high-grade ARPS, representing approximately \$7.8 million at that time. As a result, these affected securities currently are not liquid, and have been reclassified as long-term investments. For the period between June 30, 2008 through July 2, 2011, an additional \$3.9 million of our investments in ARPS were redeemed but we do not know when we will have access to the capital in these remaining investments. In the event we need to access the funds that are in an illiquid state, we will not be able to do so without a loss of principal or until a future auction on these investments is successful, the securities are redeemed by the issuer or a secondary market emerges. If we cannot readily access these funds, we may be required to borrow funds or issue additional debt or equity securities to meet our capital requirements. As of July 2, 2011, management concluded that these remaining investments were temporarily impaired and has recognized an unrealized loss in other comprehensive income totaling \$0.1 million. Management is not sure that these investments will not be settled in the short term, although the market for these investments is presently uncertain. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an additional impairment charge.

***We may be subject to liability for sales and other taxes and penalties, which could have an adverse effect on our business.***

We currently collect sales or other similar taxes only on the shipment of goods to the states of California, Kansas, Tennessee and Virginia and, through our acquisition of WAG, in Illinois and Ohio. The U.S. Supreme Court has ruled that vendors whose only connection with customers in a state is by common carrier or the U.S. mail are free from state-imposed duties to collect sales and use taxes in that state. However, states could seek to impose additional income tax obligations or sales tax collection obligations on out-of-state companies such as ours, which engage in or facilitate online commerce, based on their interpretation of existing laws, including the Supreme Court ruling, or specific facts relating to us. If sales tax obligations are successfully imposed upon us by a state or other jurisdiction, we could be exposed to substantial tax liabilities for past sales and penalties and fines for failure to collect sales taxes. We could also suffer decreased sales in that state or jurisdiction as the effective cost of purchasing goods from us increases for those residing in that state or jurisdiction.

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In addition, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's apparent position regarding sales and use taxes on Internet sales. If any of these initiatives are enacted, we could be required to collect sales and use taxes in additional states and our revenue could be adversely affected. Furthermore, the U.S. Congress has not yet extended a moratorium, which was first imposed in 1998 but has since expired, on state and local governments' ability to impose new taxes on Internet access and Internet transactions. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us as well as substantially impair the growth of e-commerce and adversely affect our revenue and profitability. Since our service is available over the Internet in multiple states, these jurisdictions may require us to qualify to do business in these states. If we fail to qualify in a jurisdiction that requires us to do so, we could face liabilities for taxes and penalties.

***We could be liable for breaches of security on our websites.***

A fundamental requirement for e-commerce is the secure transmission of confidential information over public networks. Anyone who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may adversely affect our operating results. We may be required to expend significant capital and other resources to protect against potential security breaches or to alleviate problems caused by any breach. We rely on licensed encryption and authentication technology to provide the security and authentication necessary for secure transmission of confidential information, including credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography, or other events or developments may result in a compromise or breach of the algorithms that we use to protect customer transaction data. In the event someone circumvents our security measures, it could seriously harm our business and reputation and we could lose customers. Security breaches could also expose us to a risk of loss or litigation and possible liability for failing to secure confidential customer information.

***If we do not respond to technological change, our websites could become obsolete and our financial results and conditions could be adversely affected.***

We maintain a network of websites which requires substantial development and maintenance efforts, and entails significant technical and business risks. To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our websites. The Internet and the e-commerce industry are characterized by rapid technological change, the emergence of new industry standards and practices and changes in customer requirements and preferences. Therefore, we may be required to license emerging technologies, enhance our existing websites, develop new services and technology that address the increasingly sophisticated and varied needs of our current and prospective customers, and adapt to technological advances and emerging industry and regulatory standards and practices in a cost-effective and timely manner. Our ability to remain technologically competitive may require substantial expenditures and lead time and our failure to do so may harm our business and results of operations.

***Existing or future government regulation could expose us to liabilities and costly changes in our business operations and could reduce customer demand for our products and services.***

We are subject to federal and state consumer protection laws and regulations, including laws protecting the privacy of customer non-public information and regulations prohibiting unfair and deceptive trade practices, as well as laws and regulations governing businesses in general and the Internet and e-commerce and certain environmental laws. Additional laws and regulations may be adopted with respect to the Internet, the effect of which on e-commerce is uncertain. These laws may cover issues such as user privacy, spyware and the tracking of consumer activities, marketing e-mails and communications, other advertising and promotional practices, money transfers, pricing, content and quality of products and services, taxation, electronic contracts and other communications, intellectual property rights, and information security. Furthermore, it is not clear how existing laws such as those governing issues such as property ownership, sales and other taxes, trespass, data mining and collection, and personal privacy apply to the Internet and e-commerce. For example, California has enacted legislation banning the sale of catalytic converters that do not meet California emissions regulations, and the current federal administration has indicated that 13 additional states will be allowed to enact their own legislation that mirrors the California legislation. During 2010 and in early 2011, we met with the California Air Resources Board ( CARB ) to discuss alleged sales of catalytic converters into California by us and our third-party suppliers that are not compliant with California regulations. CARB informed us that penalties may be assessed with regard to any non-compliant sales; discussions are ongoing, and any penalties are not estimable at this time. This will impact sale of products for emissions systems to those states and may adversely impact our sales and operating results. To the extent we expand into international markets, we will be faced with complying with local laws and regulations, some of which may be materially different than U.S. laws and regulations. Any such foreign law or regulation, any new U.S. law or regulation, or the interpretation or application of existing laws and regulations to the Internet or other online services or our business in general, may have a material adverse effect on our business, prospects, financial condition and results of operations by, among other things, impeding the growth



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of the Internet, subjecting us to fines, penalties, damages or other liabilities, requiring costly changes in our business operations and practices, and reducing customer demand for our products and services. We do not maintain insurance coverage to cover the types of claims or liabilities that could arise as a result of such regulation.

*We may be affected by global climate change or by legal, regulatory, or market responses to such change.*

The growing political and scientific sentiment is that global weather patterns are being influenced by increased levels of greenhouse gases in the earth's atmosphere. This growing sentiment and the concern over climate change have led to legislative and regulatory initiatives aimed at reducing greenhouse gas emissions. For example, proposals that would impose mandatory requirements on greenhouse gas emissions continue to be considered by policy makers in the United States. Laws enacted that directly or indirectly affect our suppliers (through an increase in the cost of production or their ability to produce satisfactory products) or our business (through an impact on our inventory availability, cost of sales, operations or demand for the products we sell) could adversely affect our business, financial condition, results of operations and cash flows. Significant increases in fuel economy requirements or new federal or state restrictions on emissions of carbon dioxide that may be imposed on vehicles and automobile fuels could adversely affect demand for vehicles, annual miles driven or the products we sell or lead to changes in automotive technology. Compliance with any new or more stringent laws or regulations, or stricter interpretations of existing laws, could require additional expenditures by us or our suppliers. Our inability to respond to changes in automotive technology could adversely impact the demand for our products and our business, financial condition, results of operations or cash flows.

*The United States government may substantially increase border controls and impose restrictions on cross-border commerce that may substantially harm our business.*

We purchase a substantial portion of our products from foreign manufacturers and other suppliers who source products internationally. Restrictions on shipping goods into the United States from other countries pose a substantial risk to our business. Particularly since the terrorist attacks on September 11, 2001, the United States government has substantially increased border surveillance and controls. If the United States were to impose further border controls and restrictions, impose quotas, tariffs or import duties, increase the documentation requirements applicable to cross border shipments or take other actions that have the effect of restricting the flow of goods from other countries to the United States, we may have greater difficulty acquiring our inventory in a timely manner, experience shipping delays, or incur increased costs and expenses, all of which would substantially harm our business and results of operations.

### **ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

### **ITEM 3. Defaults Upon Senior Securities.**

None.

### **ITEM 4. (Removed and Reserved)**

### **ITEM 5. Other Information**

None.



**Table of Contents****ITEM 6. Exhibits**

The following exhibits are filed herewith.

<b>Exhibit No.</b>	<b>Description</b>
3.1	Second Amended and Restated Certificate of Incorporation of U.S. Auto Parts Network, Inc. as filed with the Delaware Secretary of State on February 14, 2007 (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007)
3.2	Amended and Restated Bylaws of U.S. Auto Parts Network, Inc. (incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007)
4.1 +	Specimen common stock certificate
31.1	Certification of the principal executive officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the principal financial officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

+ Incorporated by reference to the exhibit of the same number from the registration statement on Form S-1 of U.S. Auto Parts Network, Inc. (File No. 333-138379) initially filed with the Securities and Exchange Commission on November 2, 2006, as amended.

\* Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

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**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.

Dated: August 9, 2011

U.S. AUTO PARTS NETWORK, INC.  
(Registrant)

By */s/ SHANE EVANGELIST*  
**Shane Evangelist**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

By */s/ THEODORE R. SANDERS*  
**Theodore R. Sanders**  
**Chief Financial Officer**  
**(Principal Accounting Officer)**

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