U.S. Auto Parts Network, Inc.
Form 10-Q
August 07, 2012
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

(Mark One)

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

**For the quarterly period ended June 30, 2012**

**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)**

| | |
|---|---|
| **Delaware** | **68-0623433** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**16941 Keegan 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 x 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 x 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 | x |
| 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 x

As of August 1, 2012, the registrant had 30,658,885 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 JUNE 30, 2012**

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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 , Auto-Vend , JC Whitney®, and Stylintrucks , 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 variations of these words or 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 us 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.*

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## PART I. FINANCIAL INFORMATION

### ITEM 1. Financial Statements

### U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEETS

*(in thousands, except share data and per share data)*

| | June 30, 2012 (unaudited) | December 31, 2011 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,405 | $ 10,335 |
| Short-term investments | 96 | 1,125 |
| Accounts receivable, net of allowances of $186 and $183, respectively | 9,488 | 7,922 |
| Inventory | 49,229 | 52,245 |
| Deferred income taxes | 446 | 446 |
| Other current assets | 4,093 | 3,548 |
| Total current assets | 64,757 | 75,621 |
| Property and equipment, net | 32,872 | 34,627 |
| Intangible assets, net | 9,325 | 9,984 |
| Goodwill | 18,854 | 18,854 |
| Investments | | 2,104 |
| Other non-current assets | 1,334 | 1,026 |
| Total assets | $ 127,142 | $ 142,216 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 37,182 | $ 41,303 |
| Accrued expenses | 8,669 | 11,565 |
| Revolving loan payable | 12,908 | |
| Current portion of long-term debt | | 6,250 |
| Current portion of capital leases payable | 117 | 135 |
| Other current liabilities | 5,273 | 7,702 |
| Total current liabilities | 64,149 | 66,955 |
| Long-term debt, net of current portion | | 11,625 |
| Capital leases payable, net of current portion | 91 | 37 |
| Deferred income taxes | 1,849 | 1,596 |
| Other non-current liabilities | 1,391 | 1,079 |
| Total liabilities | 67,480 | 81,292 |
| Commitments and contingencies | | |
| Stockholders equity: | | |

| | | |
|---|---|---|
| Common stock, $0.001 par value, 100,000,000 shares authorized; 30,653,356 shares issued and outstanding at June 30, 2012, and 30,625,764 shares issued and outstanding at December 31, 2011 | 31 | 31 |
| Additional paid-in-capital | 158,309 | 157,140 |
| Accumulated other comprehensive income | 380 | 327 |
| Accumulated deficit | (99,058) | (96,574) |
| Total stockholders equity | 59,662 | 60,924 |
| Total liabilities and stockholders equity | $ 127,142 | $ 142,216 |

*See accompanying notes to consolidated financial statements.*

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

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

*(unaudited, in thousands, except share and per share data)*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| Net sales | $ 80,719 | $ 84,268 | $ 168,155 | $ 171,246 |
| Cost of sales [1] | 56,378 | 55,854 | 117,186 | 112,416 |
| Gross profit | 24,341 | 28,414 | 50,969 | 58,830 |
| Operating expenses: | | | | |
| Marketing | 12,978 | 14,366 | 26,428 | 27,951 |
| General and administrative | 4,714 | 8,407 | 10,584 | 16,643 |
| Fulfillment | 5,639 | 4,592 | 11,557 | 9,599 |
| Technology | 1,700 | 1,917 | 3,236 | 3,855 |
| Amortization of intangibles | 341 | 1,363 | 681 | 2,990 |
| Total operating expenses | 25,372 | 30,645 | 52,486 | 61,038 |
| Loss from operations | (1,031) | (2,231) | (1,517) | (2,208) |
| Other income (expense): | | | | |
| Other income, net | 4 | 47 | 35 | 78 |
| Interest expense | (181) | (185) | (390) | (467) |
| Loss on debt extinguishment | (360) | | (360) | |
| Total other expense | (537) | (138) | (715) | (389) |
| Loss before income taxes | (1,568) | (2,369) | (2,232) | (2,597) |
| Income tax provision | 128 | 195 | 252 | 213 |
| Net loss | (1,696) | (2,564) | (2,484) | (2,810) |
| Other comprehensive (loss) income, net of tax: | | | | |
| Foreign currency translation adjustments | (3) | 14 | 24 | 33 |
| Unrealized gains on investments | 4 | 16 | 29 | 27 |
| Total other comprehensive income | 1 | 30 | 53 | 60 |
| Comprehensive loss | $ (1,695) | $ (2,534) | $ (2,431) | $ (2,750) |
| Basic and diluted net loss per share | $ (0.06) | $ (0.08) | $ (0.08) | $ (0.09) |
| Shares used in computation of basic and diluted net loss per share | 30,650,519 | 30,543,037 | 30,644,453 | 30,496,558 |

(1) Excludes depreciation and amortization expense which is included in marketing, general and administrative and fulfillment costs as described in *Note 1 Summary of Significant Accounting Policies and Nature of Operations* below.

*See accompanying notes to consolidated financial statements.*

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(unaudited, in thousands)*

| | Twenty-Six Weeks Ended | |
|---|---|---|
| | **June 30, 2012** | **July 2, 2011** |
| **Operating activities** | | |
| Net loss | $ (2,484) | $ (2,810) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 7,748 | 6,075 |
| Amortization of intangibles | 681 | 2,990 |
| Deferred income taxes | 253 | 219 |
| Share-based compensation | 958 | 1,324 |
| Stock awards issued for non-employee director service | 32 | |
| Amortization of deferred financing costs | 51 | 61 |
| Loss on debt extinguishment | 360 | |
| Loss from disposition of assets | 4 | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,566) | (1,990) |
| Inventory | 3,018 | 2,296 |
| Other current assets | (587) | (187) |
| Accounts payable and accrued expenses | (7,997) | (477) |
| Other current liabilities | (2,430) | (338) |
| Other non-current liabilities | 294 | 258 |
| Net cash (used in) provided by operating activities | (1,665) | 7,421 |
| **Investing activities** | | |
| Additions to property and equipment | (5,374) | (7,221) |
| Proceeds from sale of property and equipment | 14 | |
| Cash paid for intangibles | (16) | (48) |
| Proceeds from sale of marketable securities and investments | 3,171 | 400 |
| Purchases of marketable securities and investments | (7) | (13) |
| Changes in restricted cash | | 319 |
| Purchases of company-owned life insurance | (166) | (281) |
| Proceeds from purchase price adjustment | | 787 |
| Net cash used in investing activities | (2,378) | (6,057) |
| **Financing activities** | | |
| Proceeds from revolving loan payable | 16,561 | |
| Payments made on revolving loan payable | (3,653) | |
| Payments made on long-term debt | (17,875) | (3,000) |
| Payment of debt extinguishment costs | (175) | |
| Changes in book overdraft | 611 | 152 |
| Payments of debt financing costs | (345) | (53) |
| Payments on capital leases | (68) | (74) |
| Proceeds from exercise of stock options | 43 | 255 |
| Net cash used in financing activities | (4,901) | (2,720) |
| Effect of exchange rate changes on cash | 14 | 10 |

| | | |
|---|---|---|
| Net change in cash and cash equivalents | (8,930) | (1,346) |
| Cash and cash equivalents, beginning of period | 10,335 | 17,595 |
| Cash and cash equivalents, end of period | $ 1,405 | $ 16,249 |
| **Supplemental disclosure of non-cash investing and financing activities:** | | |
| Accrued asset purchases | $ 1,616 | $ 1,572 |
| Property acquired under capital lease | 104 | 32 |
| Unrealized gain on investments | 29 | 27 |
| **Supplemental disclosure of cash flow information:** | | |
| Cash paid during the period for income taxes | $ | $ 9 |
| Cash paid during the period for interest | 293 | 611 |

*See accompanying notes to consolidated financial statements.*

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 Summary of Significant Accounting Policies and Nature of Operations**

U.S. Auto Parts Network, Inc. (including 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*, *www.partstrain.com*, *www.jcwhitney.com*, *www.stylintrucks.com*, *www.AutoMD.com* and our corporate website is located at *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. The majority of these products are sold through our websites. 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 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 consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of June 30, 2012 and the consolidated results of operations for the thirteen and twenty-six weeks ended June 30, 2012 and July 2, 2011, and cash flows for the twenty-six weeks ended June 30, 2012 and July 2, 2011. 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 twenty-six weeks ended June 30, 2012 are not necessarily indicative of those to be expected for the entire fiscal year. The accompanying consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2011, which was filed with the SEC on March 26, 2012.

***Fiscal Periods***

The Company s fiscal year is based on a 52/53 week fiscal year ending on the Saturday closest to December 31. Quarterly periods are based on the thirteen weeks ending on the Saturday closest to the calendar quarter end date.

***Principles of Consolidation***

The 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, those related to revenue recognition, uncollectible receivables, the valuation of investments, valuation of inventory, valuation of deferred tax assets and liabilities, valuation of intangible assets including goodwill and other long-lived assets, recoverability of software development costs, contingencies and share-based compensation expense that results from estimated grant date fair values and vesting of issued equity awards.

Actual results could differ from these estimates.

***Fair Value of Financial Instruments***

The carrying values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value at June 30, 2012 and December 31, 2011 due to their short-term maturities. Marketable securities and investments are carried at fair value, as discussed below. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of our debt approximates its carrying amount. If the Company s new revolving loan payable (Note 6) had been measured at fair value at June 30,

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2012, it would be categorized in Level 2 of the fair value hierarchy, as the estimated value would be based on the quoted market prices for the same or similar issues or on the current rates available to the Company for debt of the same or similar terms. Accordingly, financial instruments that are not measured at fair value include accounts receivable, accounts payable and debt. Refer to *Note 3 Fair Value Measurements* for additional fair value information.

***Accounts Receivable and Concentration of Credit Risk***

Accounts receivable are stated net of allowance for doubtful accounts. The allowance for doubtful accounts is determined primarily on the basis of past collection experience and general economic conditions. The Company determines terms and conditions for its customers primarily based on the volume purchased by the customer, customer creditworthiness and past transaction history.

Concentrations of credit risk are limited to the customer base to which the Company s products are sold. The Company does not believe significant concentrations of credit risk exist.

***Marketable Securities and Investments***

Marketable securities and investments are comprised of closed-end funds primarily invested in auction rate preferred securities ( ARPS ) and mutual funds. As of June 30, 2012 our investments were primarily comprised of closed-end mutual funds. The underlying investments in ARPS were tax-exempt municipal bonds with maturities of thirty or more years, for which the interest rates are reset through a Dutch auction every seven days. In accordance with Accounting Standards Codification ( ASC ) Topic 320 *Investments Debt and Equity Securities* and based on the Company s ability to market and sell these instruments, the Company classified its ARPS as available-for-sale and carried them at fair value. Mutual 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. During 2008, the Company discounted the fair value of its investments in ARPS because of illiquidity in the market; however since that time, there has been increased liquidity resulting in our ARPS being fully redeemed at par value as of June 30, 2012 (further described in Note 3 under the caption *Financial Assets Valued on a Recurring Basis* ).

***Other-Than-Temporary Impairment***

All of the Company s marketable securities and investments are subject to a periodic impairment review. The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. The Company considers various factors in determining whether to recognize an impairment charge, including the length of time and extent to which the fair value has been less than the Company s cost basis, the financial condition and near-term prospects of the investee, and the Company s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market value. No other-than-temporary impairment charges were recorded on any investments during the twenty-six week period ended June 30, 2012 and July 2, 2011.

***Inventory***

Inventories consist of finished goods available-for-sale and are stated at the lower of cost or market value, determined using the first-in first-out 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 products are generally available from more than one supplier and seeks to maintain multiple sources for its products, both internationally and domestically. The Company primarily purchases products in bulk quantities to take advantage of quantity discounts and to assure inventory availability. Inventory is reported at the lower of cost or market, adjusted for slow moving, obsolete or scrap product. Inventory at June 30, 2012 and December 31, 2011 was $49.2 million and $52.2 million, respectively, which included items in-transit to our warehouses, in the amount of $4.8 million and $9.6 million, respectfully.

***Website and Software Development Costs***

The Company capitalizes certain costs associated with website and software developed for internal use according to ASC 350-50 *Intangibles Goodwill and Other Website Development Costs* and ASC 350-40 *Intangibles Goodwill and Other Internal-Use Software*, when both the preliminary project design and testing stage are completed and management has authorized further funding for the project, which it deems probable of completion and to be used for the function intended. Capitalized costs include amounts directly related to website and software development such as payroll and payroll-related costs for employees who are directly associated with, and who devote time to, the internal-use software project. Capitalization of such costs ceases when the project is substantially complete and ready for its intended use. These amounts are amortized on a straight-line basis over two to five years once the software is placed into service.

***Long-Lived Assets and Intangibles***

The Company accounts for the impairment and disposition of long-lived assets, including intangibles subject to amortization, in accordance with ASC 360 *Property, Plant and Equipment* ( ASC 360 ). Management assesses potential impairments whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss will result when the carrying value exceeds the undiscounted cash flows estimated to result from the use and eventual disposition of the asset. Impairment losses will be recognized in operating results to the extent that the carrying value exceeds the discounted future cash flows estimated to result from the use and eventual disposition of the asset. We continually use judgment when applying these impairment rules to determine the timing of the impairment tests, undiscounted cash flows used to assess impairments, and the fair value of a potentially impaired asset. The reasonableness of our judgments could significantly affect the carrying value of our long-lived assets. The Company did not recognize any impairment losses on long-lived assets and intangibles during the twenty-six weeks ended June 30, 2012 and July 2, 2011.

***Goodwill and Indefinite-Lived Intangibles***

The Company accounts for goodwill and indefinite-lived intangible assets in accordance with ASC 350 *Intangibles Goodwill and Other* ( ASC 350 ). Under ASC 350, goodwill and intangible assets with indefinite lives are not amortized but are tested for impairment annually or more frequently if events or circumstances occur that would indicate a reduction in fair value. In addition, the Company identified a single reporting unit (the Company itself, refer to *Segment Data* below) in accordance with ASC 280 *Segment Reporting*. The Company s annual testing date is October 31. The goodwill impairment test is a two-step impairment test. The first step compares the fair value of each reporting unit with its carrying amount including goodwill. If the carrying amount exceeds the estimated fair value, then the second step of the impairment test is performed to measure the amount of any impairment loss. Impairment losses will be recognized in operating results. ASC 350 also provides the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. During the twenty-six weeks ended June 30, 2012 and July 2, 2011, there were no events or circumstances that indicated a possible reduction in our goodwill and indefinite-lived intangible asset fair values, accordingly, no such impairment loss was recognized for periods then ended.

***Revenue Recognition***

The Company recognizes revenue from product sales when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectability is reasonably assured. The Company retains the risk of loss or damage during transit, therefore, revenue from product sales is recognized at the delivery date to customer, not upon shipment.

Revenue from sales of advertising is recorded when performance requirements of the related advertising program agreement are met.

The Company evaluates the criteria of ASC 605-45 *Revenue Recognition Principal Agent Considerations* in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. Generally, when the Company is the primary party obligated in a transaction, the Company is subject to inventory risk, has latitude in establishing prices and selecting suppliers, or has several but not all of these indicators, revenue is recorded at gross.

Product sales and shipping revenues, net of promotional discounts and return allowances, are recorded when the products are delivered and title passes to customers. Retail items sold to customers are made pursuant to terms and conditions that provide for transfer of both title and risk of loss upon our delivery to the customer. Return allowances, which reduce product revenue by the Company s best estimate of expected product returns, are estimated using historical experience.

Payments received prior to the delivery of goods to customers are recorded as deferred revenue.

The Company periodically provides incentive offers to its customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off current purchases and other similar offers. Current discount offers, when accepted by the Company s customers, are treated as a reduction to the purchase price of the related transaction.

Sales discounts are recorded in the period in which the related sale is recognized. Sales return allowances are estimated based on historical amounts and are recorded upon recognizing the related sales. Credits are issued to customers for returned products. No customer accounted for more than 10% of the Company s net sales.

***Cost of Sales***

Cost of sales consists of the direct costs associated with procuring parts from suppliers and delivering products to customers. These costs include direct product costs, outbound freight and shipping costs, warehouse supplies and warranty costs, partially offset by purchase discounts. Depreciation and amortization expenses are excluded from cost of sales and included in marketing, general and administrative and fulfillment expenses as noted below.

***Warranty Costs***

The Company or the vendors supplying it products provide the Company s customers limited warranties on certain products that range from 30 days to lifetime. In most cases, the Company s vendors are the party primarily responsible for warranty claims. Standard product warranties sold separately by the Company are recorded as deferred revenue and recognized ratably over the life of the warranty, ranging from

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one to five years. We also offer extended warranties that are imbedded in the price of selected branded products we sell. The product brands that include the extended warranty coverage are offered at three different service levels: (a) a five year unlimited product replacement, (b) a five year one-time product replacement, and (c) a three year one-time product replacement. Warranty costs relating to merchandise sold under warranty not covered by vendors are estimated and recorded as warranty obligations at the time of sale based on each product s historical return rate and historical warranty cost. During the quarter ended June 30, 2012, the Company updated its estimate of warranty obligations which resulted in an adjustment to warranty liabilities of $232,000. The standard and extended warranty obligations are recorded as warranty liabilities, included in other current liabilities in the consolidated balance sheets. For the twenty-six weeks ended June 30, 2012 and July 2, 2011, the activity in our aggregate warranty liabilities was as follows (in thousands):

| (unaudited) | June 30, 2012 | July 2, 2011 |
|---|---|---|
| Warranty liabilities, beginning of period | $ 384 | $ 154 |
| Adjustments to preexisting warranty liabilities | (232) | |
| Additions to warranty liabilities | 157 | 170 |
| Reductions to warranty liabilities | (73) | (54) |
| Warranty liabilities, end of period | $ 236 | $ 270 |

***Marketing***

Marketing costs, including advertising, are expensed as incurred. The majority of marketing expense is paid to internet search engine service providers and internet commerce facilitators. For the thirteen weeks ended June 30, 2012 and July 2, 2011, the Company recognized advertising costs of $4.6 million and $5.8 million, respectively. For the twenty-six weeks ended June 30, 2012 and July 2, 2011, the Company recognized advertising costs of $10.0 million and $11.2 million, respectively. Marketing expense also includes depreciation and amortization expense and share-based compensation expense.

***General and Administrative***

General and administrative expense consists primarily of administrative payroll and related expenses, merchant processing fees, legal and professional fees and other administrative costs. General and administrative expense also includes depreciation and amortization expense and share-based compensation expense.

***Fulfillment***

Fulfillment expense consists primarily of payroll and related costs associated with warehouse employees and our purchasing group, facilities rent, building maintenance, depreciation and other costs associated with inventory management and wholesale operations. Fulfillment expense also includes share-based compensation expense.

***Technology***

Technology expense consists primarily of payroll and related expenses of our information technology personnel, the cost of hosting our servers, communications expenses and Internet connectivity costs, computer support and software development. Technology expense also includes share-based compensation expense.

***Share-Based Compensation***

The Company accounts for share-based compensation in accordance with ASC 718 *Compensation 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 statement of comprehensive income or loss as marketing, general and administrative, fulfillment or technology expense, based on employee departmental classifications.

Under this standard, 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, with the exception of options granted containing market conditions, for which the Company estimates the fair value using a Monte Carlo model. The determination of the fair value of share-based payment awards utilizing the Black-Scholes and Monte Carlo models 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.

Prior to January 1, 2012, the Company estimated volatility using the historical volatilities of similar public entities. Due to the limited period of time our equity shares have been publicly traded, we did not have sufficient historical market price data to provide a reasonable basis upon which to estimate volatility. As of January 1, 2012, the Company has incorporated its own historical volatility into the grant-date fair value calculations. The Company s historical volatility was not materially different than the estimates applied to past award fair value calculations. The expected term of an award is based on combining historical exercise data with expected weighted time outstanding.

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Expected weighted time outstanding is calculated by assuming the settlement of outstanding awards is at the midpoint between the remaining weighted average vesting date and the expiration date. Prior to January 1, 2012, the expected life of an award was estimated using the simplified method as provided in ASC 718. Under this method, the expected life equals the arithmetic average of the vesting term and the original contractual term of the award. The Company used the simplified method as it did not have sufficient historical exercise data to provide a reasonable basis upon which to estimate an expected term. The risk-free interest rate assumption is based on observed interest rates appropriate for the expected life 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 significantly differ from those estimates. The Company considers many factors when estimating expected forfeitures, including employee class, economic environment, and historical experience.

The Company accounts for equity instruments issued in exchange for the receipt of services from 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 other than 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 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.

***Other Income, net***

Other income, net consists of miscellaneous income or expense such as gains/losses from disposition of assets, and interest income comprised primarily of interest income on investments.

***Interest Expense***

Interest expense consists primarily of interest expense on our outstanding loan balance, deferred financing cost amortization, and capital lease interest.

***Income Taxes***

The Company accounts for income taxes in accordance with ASC 740 *Income Taxes* ( ASC 740 ). Under ASC 740, deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. When appropriate, a valuation allowance is established to reduce deferred tax assets, which include tax credits and loss carry forwards, to the amount that is more likely than not to be realized. In making such determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in prior carryback years, tax planning strategies and recent financial operations.

The Company utilizes a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. As of June 30, 2012, 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 interest and penalties as income tax expense.

***Foreign Currency Translation***

For each of the Company s foreign subsidiaries, the functional currency is its local currency. Assets and liabilities of foreign operations are translated into U.S. dollars using the current exchange rates, and revenues and expenses are translated into U.S. dollars using average exchange rates. The effects of the foreign currency translation adjustments are included as a component of accumulated other comprehensive income or loss in our consolidated balance sheets.

***Comprehensive Loss***

The Company reports comprehensive income or loss in accordance with ASC 220 *Comprehensive Income*. Accumulated other comprehensive income or loss, included in our consolidated balance sheets, includes foreign currency translation adjustments related to the Company s foreign operations, and unrealized holding gains and losses from available-for-sale marketable securities and investments. The Company presents the components of net income or loss and other comprehensive income or loss, in our consolidated statements of comprehensive income or loss.

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***Segment Data***

The Company operates in one reportable segment and reporting revenues by product line or geographic location is impracticable. Certain long-lived assets are held in the Philippines (refer to *Note 4 Property and Equipment, Net* ). The criteria the Company used to identify our reporting segment are primarily the nature of the products the Company sells and the consolidated operating results that are regularly reviewed by the Company s chief operating decision maker to assess performance and make operating decisions.

***Recent Accounting Pronouncements***

In May 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( 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 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 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 ( IFRS ). However, some could change how the fair value measurement guidance in ASC 820 is applied. The Company adopted the provisions of ASU 2011-04 on January 1, 2012. The adoption did not have a material impact on the Company s consolidated financial statements.

In June and December 2011, the FASB issued two ASU s which amend guidance for the presentation of comprehensive income, an update to ASC 220 *Comprehensive Income*. The amended guidance requires an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. The current option to report other comprehensive income and its components in the statement of stockholders equity has been eliminated. Although the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under existing guidance. These ASU s were adopted by the Company on January 1, 2012 and changed our financial statement presentation of comprehensive loss, to one continuous statement, but did not impact our net loss, financial position, or cash flows.

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. The amendments in this ASU require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of IFRS. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Company believes that the adoption will not have a material impact on the Company s consolidated financial statements.

**Note 2 Investments**

As of June 30, 2012, the Company held the following securities and investments, recorded at fair value (in thousands):

| (unaudited) | | Unrealized | | |
|---|---|---|---|---|
| | Amortized Cost | Gains | Losses | Fair Value |
| Mutual funds (1) | $ 94 | $ 2 | $ | $ 96 |

As of December 31, 2011, the Company held the following securities and investments, recorded at fair value (in thousands):

| | | Unrealized | | |
|---|---|---|---|---|
| | Amortized Cost | Gains | Losses | Fair Value |
| Mutual funds (1) | $ 1,011 | $ 114 | $ | $ 1,125 |

| | | | | |
|---|---|---|---|---|
| Auction rate preferred securities in municipal and state agencies (2) | 2,125 | | (21) | 2,104 |
| Total | $ 3,136 | $ 114 | $ (21) | $ 3,229 |

(1) Mutual 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.

(2) Auction rate preferred securities in municipal and state agencies with maturities of 15 to 30 years were classified as investments available-for-sale and recorded at fair value. During the twenty-six weeks ended June 30, 2012, the remaining securities balance at

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December 31, 2011 was fully redeemed. As of December 31, 2011, these securities were held in two tax-exempt municipal bonds managed under closed-end funds and were classified as long-term investments. Refer to additional information in Note 3 under the caption *Financial Assets Valued on a Recurring Basis* .

Proceeds from the sale of available-for-sale securities and investments are disclosed separately in the accompanying consolidated statements of cash flow. For the twenty-six weeks ended June 30, 2012, the Company recognized a realized loss of $4,000 from the sale of mutual funds. For the twenty-six weeks ended July 2, 2011, there were no recognized realized gains or losses from the sale of available-for-sale securities and investments.

**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:

**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.

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

As of June 30, 2012 and December 31, 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 cash, cash equivalents and investments. 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 (in thousands):

| | As of June 30, 2012 | | | |
|---|---|---|---|---|
| (unaudited) | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash and cash equivalents (1) | $ 1,405 | $ 1,405 | $ | $ |
| Investments mutual funds (2) | 96 | 96 | | |
| Total | $ 1,501 | $ 1,501 | $ | $ |

| | As of December 31, 2011 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash and cash equivalents (1) | $ 10,335 | $ 10,335 | $ | $ |
| Investments mutual funds (2) | 1,125 | 1,125 | | |
| Investments ARPS (3) | 2,104 | | | 2,104 |
| Total | $ 13,564 | $ 11,460 | $ | $ 2,104 |

(1) Cash equivalents consist primarily of money market funds and short-term investments 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)

Investments consist of mutual funds, 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.

(3) During the twenty-six weeks ended June 30, 2012, the remaining ARPS balance at December 31, 2011 was fully redeemed. As of December 31, 2011, the Company had invested $2.1 million (par value) in ARPS, which were classified as long-term available-for-sale securities and reflected at $2.1 million (fair value), which included an unrealized loss of $21,000. The Company has included its investments related to ARPS in the Level 3 category.

Before utilizing Level 3 inputs in the fair value measurement of our ARPS, 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 June 30, 2008 and the anticipated future market for such investments. These investments consisted solely of collateralized debt obligations supported by municipal and state agencies; did not include mortgage-backed securities or student loans; had redemption features that called for redemption at 100% of par value (originally totaling $7.8 million in 2008); and had a credit rating of A or AAA. For the period from June 30, 2008 through June 30, 2012, the Company redeemed 100% of its investment at par value totaling $7.8 million, which included $25,000 during the quarter ended March 31, 2012 and $2.1 million during the quarter ended June 30, 2012. As of December 31, 2011, we continued to classify our ARPS as long-term due to the historical uncertainties at that time. The fact that there was not an active market to liquidate these investments was a determining factor 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 of these securities utilizing a discounted cash flow valuation model. On a quarterly basis we evaluated the reasonableness of the significant unobservable inputs used in our ARPS fair value measurements. The valuation model used for our ARPS investments required an evaluation of 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. Based on these factors, we assessed the risk of realizing expected cash flows and we applied an estimated term and observable discount rate that reflected this risk. As a result of the temporary declines in fair value for the Company s ARPS, the Company recorded an unrealized holding loss of $21,000 to accumulated other comprehensive income as of December 31, 2011. If the Company had determined that any decrease in the value of the instruments was other-than-temporary, it would have recorded a charge to earnings as appropriate.

During the twenty-six weeks ended June 30, 2012 and July 2, 2011, there were no transfers into or out of Level 1, Level 2 or Level 3 assets. The following tables present the Company s ARPS activity measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the twenty-six weeks ended June 30, 2012 and July 2, 2011 (in thousands):

| (unaudited) | Level 3 Investments |
|---|---|
| Balance as of December 31, 2011 | $ 2,104 |
| Redemption at par value | (2,125) |
| Unrealized gains included in other comprehensive income | 21 |
| Balance as of June 30, 2012 | $ |

| (unaudited) | Level 3 Investments |
|---|---|
| Balance as of January 1, 2011 | $ 4,141 |
| Redemption at par value | (400) |
| Unrealized gains included in other comprehensive income | 25 |
| Balance as of July 2, 2011 | $ 3,766 |

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

The Company s long-lived and indefinite-lived 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 June 30, 2012, the Company s long-lived and indefinite-lived assets did not indicate a potential impairment under the provisions of ASC 350 and ASC 360, as such, they were not measured at fair value. The Company did not recognize any impairment losses on long-lived or indefinite-lived assets during the twenty-six weeks ended June 30, 2012 and July 2, 2011. If such non-financial assets had been measured at fair value, they would be categorized in Level 3 of the fair value hierarchy, as the Company would be required to develop its own assumptions and analysis to determine if such non-financial assets were impaired.

As of December 31, 2011, the Company recorded an impairment loss on certain acquired trade name intangible assets in the amount of $5.1 million, which adjusted such assets to their fair value at that time.

**Note 4 Property and Equipment, Net**

The Company s fixed assets consisted of computer software (purchased and internally developed), machinery and equipment, furniture and fixtures, and vehicles, and are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable and amortizable assets to operations over their estimated service lives. Depreciation expense for the thirteen weeks ended June 30, 2012 and July 2, 2011 was $4.0 million and $3.1 million, respectively. Depreciation expense for the twenty-six weeks ended June 30, 2012 and July 2, 2011 was $7.7 million and $6.1 million, respectively. The cost and related accumulated depreciation of assets retired or otherwise disposed of are removed from the accounts and the resultant gain or loss is reflected in earnings.

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Property and equipment consisted of the following at June 30, 2012 and December 31, 2011 (in thousands):

| | June 30, 2012 (unaudited) | December 31, 2011 |
|---|---|---|
| Land | $ 630 | $ 630 |
| Building | 10,680 | 10,680 |
| Machinery and equipment | 13,946 | 13,429 |
| Computer software (purchased and developed) and equipment | 41,954 | 37,880 |
| Vehicles | 249 | 221 |
| Leasehold improvements | 2,428 | 2,122 |
| Furniture and fixtures | 1,359 | 1,244 |
| Construction in process | 3,460 | 2,467 |
| | 74,706 | 68,673 |
| Less accumulated depreciation and amortization | (41,834) | (34,046) |
| Property and equipment, net | $ 32,872 | $ 34,627 |

Certain of the Company s net property and equipment was located in the Philippines as of June 30, 2012 and December 31, 2011, in the amount of $1.3 million and $1.6 million, respectively.

Depreciation of property and equipment is provided using the straight-line method for financial reporting purposes, based on the following estimated useful lives:

| | Years |
|---|---|
| Building | 21 |
| Machinery and equipment | 2 - 5 |
| Computer software (purchased and developed) | 2 - 5 |
| Computer equipment | 2 - 5 |
| Vehicles | 3 - 5 |
| Leasehold improvements* | 3 - 5 |
| Furniture and fixtures | 3 - 7 |

* The estimated useful life is the lesser of 3-5 years or the lease term.

**Note 5 Goodwill and Intangibles**

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, 2011, the Company performed its annual impairment test and the excess of fair value estimates over carrying value for our reporting unit was approximately $50 million. Based on its analysis, there would have to be a 38% decrease in the estimated fair value of the reporting unit to fail step 1. As of June 30, 2012, there was no change to the Company s reporting unit and no events or circumstances occurred that would indicate an impairment of goodwill based on the excess of estimated fair value over carrying value for our reporting unit.

The carrying value of goodwill remained unchanged during the twenty-six weeks ended June 30, 2012 (in thousands):

| (unaudited) | |
|---|---|
| Balance at December 31, 2011 | $ 18,854 |

| Change in goodwill | |
|---|---|
| Balance at June 30, 2012 | $ 18,854 |

As of June 30, 2012, the accumulated impairment loss on goodwill was $4.4 million (recorded in 2008).

During the twenty-six weeks ended June 30, 2012, the Company incurred legal protection costs for certain domain and trade names of $16,000 which was allocated to intangible assets not subject to amortization. During the twenty-six weeks ended July 2, 2011, the Company purchased certain domain and trade names in the amount of $48,000, which was allocated to intangible assets not subject to amortization.

The Company did not note events or changes in circumstances indicating that the carrying value of our intangible assets may not be recoverable during the twenty-six weeks ended June 30, 2012 and July 2, 2011, therefore, no impairment loss was recognized on intangible assets as of the periods then ended.

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Intangible assets subject to amortization are expensed on a straight-line basis. Amortization expense relating to intangible assets for the thirteen weeks ended June 30, 2012 and July 2, 2011 was $0.3 million and $1.4 million, respectively. Amortization expense relating to intangible assets for the twenty-six weeks ended June 30, 2012 and July 2, 2011 was $0.7 million and $3.0 million, respectively.

Intangibles, excluding goodwill, consisted of the following at June 30, 2012 and December 31, 2011 (in thousands):

| | | June 30, 2012 (unaudited) | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|---|
| | **Useful Life** | **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 | $ (1,204) | $ 831 | $ 2,035 | $ (1,001) | $ 1,034 |
| Internet platform intellectual property | 10 months | | | | 4,300 | (4,300) | |
| Product design intellectual property | 9 years | 2,750 | (569) | 2,181 | 2,750 | (416) | 2,334 |
| Customer relationships | 4 years | 2,050 | (972) | 1,078 | 2,050 | (712) | 1,338 |
| Assembled workforce | 7 years | 497 | (332) | 165 | 481 | (275) | 206 |
| Favorable lease | 2.5 years | 78 | (74) | 4 | 78 | (56) | 22 |
| Sub-Total | | 7,410 | (3,151) | 4,259 | 11,694 | (6,760) | 4,934 |
| Intangible assets not subject to amortization: | | | | | | | |
| Domain and trade names | Indefinite life | 5,066 | | 5,066 | 5,050 | | 5,050 |
| Total | | $ 12,476 | $ (3,151) | $ 9,325 | $ 16,744 | $ (6,760) | $ 9,984 |

The following table summarizes the future estimated annual amortization expense for these assets over the next five years, as of June 30, 2012 (in thousands):

| (unaudited) | |
|---|---|
| 2013 | $ 1,316 |
| 2014 | 1,089 |
| 2015 | 600 |
| 2016 | 307 |
| 2017 | 306 |
| Thereafter | 641 |
| Total | $ 4,259 |

**Note 6 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 was the lender under the Facility. The Facility was 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 had a final maturity date of June 30, 2014, and borrowings under the Facility were interest bearing, at the election of the Company, at LIBOR (with a floor of 1.25%) plus a margin from 2.00% to 3.00% per annum, or at the Wall Street Journal Prime Rate plus a margin 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 was 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 was payable no less than quarterly and the outstanding principal of the term loan was 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 were secured by liens over all assets of the Company, including shares of stock in each of the Company s subsidiaries.

The Loan Agreement required the Company to comply with a number of restrictive covenants, including financial covenants related to maximum funded debt to consolidated earnings before interest, taxes, depreciation and amortization ( EBITDA ), as defined, 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 the Company s assets; and other customary covenants. The Company and Silicon Valley Bank entered into three amendments to the Loan Agreement through December 2011. During March 2012, the Company determined it was probable that the consolidated fixed charge coverage ratio would not be in compliance with the required 1.50:1.00 minimum level for the quarter ending March 31, 2012. This determination was made during the

Company s monitoring of their covenants, which includes monthly calculations of consolidated EBITDA projected to quarter end. As a result, on March 23, 2012, the Company and Silicon Valley Bank entered into a fourth amendment, which reduced the required consolidated fixed charge coverage ratio to a minimum of 1.00:1:00 for the one quarter ending March 31, 2012 and to 1.25:1.00 for each quarter ending thereafter.

The remaining term loan balance as of March 31, 2012 of $17.9 million was scheduled for repayment through June 2014. The Facility was repaid in full in April 2012 with a revolving loan arrangement.

On April 26, 2012, the Company, certain of its wholly-owned domestic subsidiaries and JPMorgan Chase Bank, N.A., as sole lender and administrative agent entered into a Credit Agreement (the Credit Agreement ). The Credit Agreement provides for a revolving commitment in an aggregate principal amount of up to $40,000,000 (the Credit Facility ), which is subject to a borrowing base derived from certain receivables, inventory, property and pledged cash. The Credit Facility matures on April 26, 2017. The Company used the proceeds of the loans borrowed on the closing date to repay in full its previous credit facility with Silicon Valley Bank. In connection with the payoff of our previous credit facility, the Company recorded a loss on debt extinguishment of $360,000 which was comprised of a prepayment fee in the amount of $166,000, accelerated deferred financing costs in the amount of $185,000 and other direct expenses related to the previous debt. At June 30, 2012, our outstanding revolving loan balance was $12.9 million. The customary events of default under the Credit Facility (discussed below) include certain subjective acceleration clauses, which management has determined the likelihood of such acceleration is more than remote, considering the recurring losses experienced by the Company, therefore a current classification of our long-term loan balance was required as of June 30, 2012.

Loans drawn under the Credit Facility bear interest, at the Company s option, at a per annum rate equal to either (a) LIBOR plus an applicable margin of 1.50%, or (b) an alternate base rate minus an applicable margin of 0.50%. Each applicable margin as set forth in the prior sentence is subject to increase or decrease by 0.25% per annum based upon the Company s fixed charge coverage ratio. At June 30, 2012, the Company s LIBOR based interest rate was 1.75% (on $10.0 million principal) and the Company s Prime based rate was 2.75% (on $2.9 million principal). The Company made no loan draws under the Credit Facility as of June 30, 2012; however in July 2012, the Company borrowed a total of $5.5 million with interest currently at 2.75% (Prime minus 0.50%). Interest-only payments are currently due monthly. A commitment fee, based upon undrawn availability under the Credit Facility bearing interest at a rate of 0.20% per annum, is payable monthly. Under the terms of the Credit Agreement, cash receipts are deposited into a lock-box, which are at the Company s discretion unless the cash dominion period is in effect, during which cash receipts will be used to reduce amounts owing under the Credit Agreement. The cash dominion period is triggered in an event of default or if excess availability is less than $6,000,000 at any time, as defined, and will continue until, during the preceding 60 consecutive days, no event of default existed and excess availability has been greater than $7,000,000 at all times. The Company s excess availability was $14.9 million at June 30, 2012. As of the date hereof, the cash dominion period has not been in effect; accordingly no principal payments are currently due.

Certain of the Company s wholly-owned domestic subsidiaries are co-borrowers (together with the Company, the Borrowers ) under the Credit Agreement, and certain other wholly-owned domestic subsidiaries are guarantors (the Guarantors and, together with the Borrowers, the Loan Parties ) under the Credit Agreement. The Borrowers and the Guarantors are jointly and severally liable for the Borrowers obligations under the Credit Agreement. The Loan Parties obligations under the Credit Agreement are secured, subject to customary permitted liens and certain exclusions, by a perfected security interest in (a) all tangible and intangible assets and (b) all of the capital stock owned by the Loan Parties (limited, in the case of foreign subsidiaries, to 65% of the capital stock of such foreign subsidiaries). The Borrowers may voluntarily prepay the loans at any time without payment of a premium. The Borrowers are required to make mandatory prepayments of the loans (without payment of a premium) with net cash proceeds received upon the occurrence of certain prepayment events, which include certain sales or other dispositions of collateral, certain casualty or condemnation events, certain equity issuance or capital contributions, and the incurrence of certain debt. The Borrowers have the right to increase the revolving commitments up to and above $60,000,000. Borrowers may make a maximum of three such requests in a minimum amount of $5,000,000 each. Upon approval of such an increase, the aggregate revolving commitment amount will be revised and the Credit Agreement amended as appropriate. The SEC requires that condensed consolidating financial information be provided for the subsidiaries that have guaranteed the debt of the parent company of those subsidiaries, where the guarantee is full and unconditional and where the voting interest of the subsidiary is 100% owned by the parent company. All items in our consolidated balance sheets relate to the parent company and all items in our consolidated statements of comprehensive loss relate to our non-guarantor subsidiaries, therefore condensed consolidating financial information is not presented herein.

The Credit Agreement contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries, including, among other things, restrictions on indebtedness, liens, fundamental changes, investments, dispositions, prepayment of other indebtedness, mergers, and dividends and other distributions. Under the Credit Agreement, the Company is not required to maintain a minimum fixed charge coverage ratio, unless excess availability is less than $6,000,000, as defined, whereby a ratio of 1.0 to 1.0 will be required. Events of default under the Credit Agreement include: failure to timely make payments due under the Credit Agreement; material misrepresentations or misstatements under the Credit Agreement and other related agreements; failure to comply with covenants under the Credit Agreement and other related agreements; certain defaults in respect of other material indebtedness; insolvency or other related events;

certain defaulted judgments; certain ERISA-related events; certain security interests or liens under the loan documents cease to be, or are challenged by the Company or any of its subsidiaries as not being, in full force and effect; any loan document or any material provision of the same ceases to be in full force and effect; and certain criminal indictments or convictions of any Loan Party. As of June 30, 2012, the Company was in compliance with all covenants under the Credit Agreement.

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As of June 30, 2012, the Company had a capital lease obligation of $208,000.

**Note 7 Stockholders Equity and Share-Based Compensation**

***Common Stock***

The Company has 100,000,000 shares of common stock authorized. The Company has never paid cash dividends on its common stock. The following issuances of common stock were made during the twenty-six weeks ended June 30, 2012:

The Company issued 20,000 shares of common stock from option exercises under its 2007 Omnibus Incentive Plan, as discussed below.

7,592 shares of common stock were awarded and issued to one non-employee member of the Board of Directors for service fees earned in the aggregate amount of $31,875. An additional 2,529 shares of common stock were awarded to the same non-employee director for services rendered during the thirteen weeks ended June 30, 2012 in the amount of $10,625; such shares were issued in July 2012. Such common stock was awarded from the 2007 Omnibus Incentive Plan, discussed below.

***Share-Based Compensation Plan Information***

The Company adopted the 2007 Omnibus Incentive Plan (the 2007 Omnibus Plan ) in January 2007, which became effective on the effective date (February 8, 2007) of the registration statement filed in connection with the Company s initial public offering. Under the 2007 Omnibus Plan, the Company is authorized to issue shares of common stock under various instruments to eligible employees and non-employees of the Company. Options granted under the 2007 Omnibus Plan generally expire no later than ten years from the date of grant and generally vest over a period of four years. The exercise price of all option grants must be equal to 100% of the fair market value on the date of grant. The 2007 Omnibus Plan also provides for automatic grant of options to purchase common stock and common stock awards to non-employee directors. At June 30, 2012, 1,865,895 shares were available for future grants under the 2007 Omnibus Plan.

The following table summarizes the Company s stock option activity under the 2007 Omnibus Plan for the twenty-six weeks ended June 30, 2012:

| (unaudited) | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Options outstanding, December 31, 2011 | 5,526,090 | $ 4.51 | 6.95 | |
| Granted | 777,500 | $ 4.21 | | |
| Exercised | (20,000) | $ 2.14 | | |
| Expired | (165,000) | $ 4.75 | | |
| Forfeited | (100,000) | $ 7.80 | | |
| Options outstanding, June 30, 2012 | 6,018,590 | $ 4.42 | 7.08 | $ 4,649,000 |
| Options exercisable, June 30, 2012 | 3,938,350 | $ 4.06 | 6.13 | $ 4,020,000 |

The weighted-average fair value of options granted during the twenty-six weeks ended June 30, 2012 was $2.65 per share.

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. During the twenty-six weeks ended June 30, 2012, the total intrinsic value of the exercised options was $52,000. Aggregate Intrinsic Value (in the table above) is calculated as the difference between the exercise price of underlying awards and the fair value price of the Company s common stock for options that were in-the-money as of June 30, 2012.

Under the 2007 Omnibus Plan, the Company had $2.8 million of unrecognized share-based compensation expense related to stock options outstanding as of June 30, 2012, which expense is expected to be recognized over a weighted-average period of 2.79 years.

The Company adopted the 2007 New Employee Incentive Plan (the 2007 New Employee Plan ) in October 2007. Under the 2007 New Employee Plan, the Company is authorized to issue 2.0 million shares of common stock under various instruments solely to new employees. Options granted under the 2007 New Employee Plan generally expire no later than ten years from the date of grant and generally vest over a period of four years. The exercise price of all option grants must not be less than 100% of the fair market value on the date of grant. As of June 30, 2012, 1,183,333 options were outstanding and exercisable, and 816,667 shares were available for future grants, under the 2007 New Employee Plan. During the twenty-six weeks ended June 30, 2012, 66,667 options were forfeited under the 2007 New Employee Plan. Under the 2007 New Employee Plan, the Company had no unrecognized share-based compensation expense related to stock options outstanding as of June 30, 2012.

The Company adopted the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan (the 2006 Plan ) in March 2006. All stock options to purchase common stock granted to employees in 2006 were granted under the 2006 Plan and had exercise prices equal to the fair value of the underlying stock, as determined by the Company s Board of Directors on the applicable option grant date. After fiscal 2008, no shares have been available for future grants under the 2006 Plan. As of June 30, 2012, 672,628 options were outstanding and exercisable under the 2006 Plan. During the twenty-six weeks ended June 30, 2012, 6,000 options expired under the 2006 Plan. Under the 2006 Plan, the Company has fully recognized share-based compensation expense related to the 2006 Plan stock options outstanding as of June 30, 2012.

***Warrants***

On May 5, 2009, the Company issued warrants to purchase up to 30,000 shares of common stock at an exercise price of $2.14 per share, 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 vested in thirty-six equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing May 5, 2009. The grant date fair value of these warrants issued on May 5, 2009 was $1.09 per share. Accordingly, these non-employee equity instruments were re-measured as they vested over the requisite service period. These warrants became fully vested during the quarter ended June 30, 2012, in which the final re-measured fair value was $3.14 per share.

On April 27, 2010, the Company issued additional warrants to purchase up to 20,000 shares of common stock at an exercise price of $8.32 per share, to the same consultant in connection with the financial advisory services provided to the Company. The warrants terminate seven years after their grant date. The warrants vested in twenty-four equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing April 27, 2010. The grant date fair value of the additional warrants issued on April 27, 2010 was $2.12 per share. Accordingly, these non-employee equity instruments were re-measured as they vested over the requisite service period. These warrants became fully vested during the quarter ended March 31, 2012, in which the final re-measured fair value was $1.42 per share.

The Company determined the fair value of the warrants at the date of grant, and upon the re-measurement dates, using the Black-Scholes option pricing model based on the fair value of the underlying common stock, the exercise price, remaining contractual term, risk-free rate and expected volatility. No warrants were exercised during the twenty-six weeks ended June 30, 2012. As of June 30, 2012, warrants to purchase 50,000 shares of common stock were outstanding and exercisable. Aggregate intrinsic value of outstanding and exercisable warrants was $61,000 as of June 30, 2012, which was calculated as the difference between the exercise price of underlying awards and the fair value price of the Company s common stock for warrants that were in-the-money. Total warrants share-based compensation expense recognized during the thirteen weeks ended June 30, 2012 and July 2, 2011 amounted to $5,000 and $17,000, respectively. Total warrants share-based compensation expense recognized during the twenty-six weeks ended June 30, 2012 and July 2, 2011 amounted to $16,000 and $43,000, respectively. The Company had no unrecognized share-based compensation expense related to warrants outstanding as of June 30, 2012.

***Performance Stock Options***

During the twenty-six weeks ended June 30, 2012, under the 2007 Omnibus Plan, the Board of Directors approved performance options to purchase 125,000 shares of common stock for certain employees of the Company that vest over a four-year period based on the achievement of operational goals. Certain performance options contain vesting acceleration clauses. The performance option grants were valued using the Black-Scholes option pricing model in the same manner as other stock option grants, as discussed below. One previously granted performance option was forfeited in connection with the performance goals not being met at the end of the requisite service period. Accordingly, $105,000 of previously recognized share-based compensation expense was reversed during the twenty-six weeks ended June 30, 2012.

***Share-Based Compensation Expense***

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions for each of the twenty-six week periods ended:

| (unaudited) | **June 30, 2012** | **July 2, 2011** |
|---|---|---|
| Expected life | 5.73 years | 6 6.25 years |
| Risk-free interest rate | 1.0% 1.2% | 2.0% 2.6% |
| Expected volatility | 73% 74% | 50% |
| Expected dividend yield | 0% | 0% |

Share-based compensation from options, warrants and stock awards, is included in our consolidated statements of comprehensive loss as follows (in thousands):

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| (unaudited) | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| Marketing expense | $ 152 | $ 88 | $ 196 | $ 248 |
| General and administrative expense | 155 | 399 | 577 | 775 |
| Fulfillment expense | 43 | 91 | 136 | 176 |
| Technology expense | 24 | 65 | 49 | 125 |
| Total share-based compensation expense | $ 374 | $ 643 | $ 958 | $ 1,324 |

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Share-based compensation expense (in the table above) is net of amounts capitalized to internally-developed software, including $85,000 and $58,000 during the thirteen weeks ended June 30, 2012 and July 2, 2011, respectively, and $136,000 and $111,000 during the twenty-six weeks ended June 30, 2012 and July 2, 2011, respectively. The table above excludes the expense from issuing stock awards to one non-employee director for services rendered, in the amount of $10,625 and $21,250, for the thirteen and twenty-six weeks ended June 30, 2012, respectively; no such expenses were incurred in fiscal 2011.

Under ASC 718, forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures significantly differ from those estimates. Our estimated forfeiture rates are calculated based on actual historical forfeitures experienced under our equity plans. In the first quarter of fiscal 2012, the Company performed a periodic review of the estimated forfeiture rates and determined an increase to the existing forfeiture rates was necessary. This increase was primarily attributed to higher terminations in the non-executive employee group than was previously expected. Accordingly, the Company updated the forfeiture rates from 10% to 18%, to 16% to 34% and has applied such revised rates during the twenty-six weeks ended June 30, 2012.

There was $2.8 million, net of estimated forfeitures of approximately $3.2 million, of unrecognized compensation expense related to stock options and warrants as of June 30, 2012, which expense is expected to be recognized over a weighted-average period of 2.79 years.

**Note 8 Net Loss Per Share**

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

| (unaudited) | Thirteen Weeks Ended June 30, 2012 | Thirteen Weeks Ended July 2, 2011 | Twenty-Six Weeks Ended June 30, 2012 | Twenty-Six Weeks Ended July 2, 2011 |
|---|---|---|---|---|
| **Net loss per share:** | | | | |
| Numerator: | | | | |
| Net loss | $ (1,696) | $ (2,564) | $ (2,484) | $ (2,810) |
| Denominator: | | | | |
| Weighted-average common shares outstanding (basic) | 30,650,519 | 30,543,037 | 30,644,453 | 30,496,558 |
| Common equivalent shares from common stock options and warrants | | | | |
| Weighted-average common shares outstanding (diluted) | 30,650,519 | 30,543,037 | 30,644,453 | 30,496,558 |
| Basic and diluted net loss per share | $ (0.06) | $ (0.08) | $ (0.08) | $ (0.09) |

The weighted-average anti-dilutive securities, which are excluded from the calculation of diluted earnings per share due to the Company s net loss position for the periods then ended (including securities that would otherwise be excluded from the calculation of diluted earnings per share due the Company s stock price), are as follows:

| (unaudited) | Thirteen Weeks Ended June 30, 2012 | Thirteen Weeks Ended July 2, 2011 | Twenty-Six Weeks Ended June 30, 2012 | Twenty-Six Weeks Ended July 2, 2011 |
|---|---|---|---|---|
| Common stock warrants | 50,000 | 50,000 | 50,000 | 50,000 |
| Options to purchase common stock | 7,808,507 | 7,293,001 | 7,751,657 | 7,137,593 |
| Total | 7,858,507 | 7,343,001 | 7,801,657 | 7,187,593 |

**Note 9 Income Taxes**

As discussed in *Note 1 Summary of Significant Accounting Policies and Nature of Operations*, the Company applies the current U.S. GAAP on accounting for uncertain tax positions, which prescribe a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that has greater than 50 percent likelihood of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. As of June 30, 2012, 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 interest and penalties 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 tax years 2007-2011 remain open to examination by the major taxing jurisdictions to which the Company is subject, except the Internal Revenue Service for which the tax years 2009-2011 remain open. The Company does not anticipate a significant change to the amount of unrecognized tax benefits within the next twelve months.

For the thirteen weeks ended June 30, 2012 and July 2, 2011, the effective tax rate for the Company was (8.2)% and (8.2)%, respectively. For the twenty-six weeks ended June 30, 2012 and July 2, 2011, the effective tax rate for the Company was (11.2)% and (8.2)%, respectively. The Company s effective tax rate for the thirteen and twenty-six weeks ended June 30, 2012 differed from the U.S. federal statutory rate primarily as a result of the recording of valuation allowance against the pre-tax losses and the increase in deferred tax liabilities related to tax deductible indefinite-lived intangible assets, as well as tax expense incurred outside of the U.S. 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 as a result of the recording of valuation allowance against pre-tax losses and the increase in deferred tax liabilities related to tax deductible indefinite-lived intangible assets.

**Note 10 Commitments and Contingencies**

***Facilities Leases***

The Company s corporate headquarters and warehouse facilities are located in Carson, California. As of June 30, 2012, we maintained multiple separate leases for the Carson, California facilities. The Company s primary facilities are under one sublease agreement with an initial five year term through October 2016, and optional renewals through January 2020. The Company also leases warehouse space in Chesapeake, Virginia under an agreement scheduled to expire June 2016. The Company also leases office and warehouse space in Independence, Ohio under an agreement through January 2013, with two five-year renewal options. The Company s Philippines subsidiary leases office space under a sixty-three month agreement through May 2015, renewable for an additional sixty months through April 2020. As of the date hereof, the Company has not committed to any facilities lease renewals.

Facility rent expense for the thirteen weeks ended June 30, 2012 and July 2, 2011 was $0.6 million and $0.7 million, respectively. The Company s facility rent expense was inclusive of amounts charged from a related party during the thirteen weeks ended June 30, 2012 and July 2, 2011 of $0.1 million and $0.1 million, respectively. Facility rent expense for the twenty-six weeks ended June 30, 2012 and July 2, 2011 was $1.2 million and $1.3 million, respectively. The Company s facility rent expense was inclusive of amounts charged from a related party during the twenty-six weeks ended June 30, 2012 and July 2, 2011 of $0.2 million and $0.2 million, respectively.

***Legal Matters***

***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 oral argument before the 9th Circuit Court of Appeals occurred on March 6, 2012. The ruling on the appeal by 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. In addition, the Company believes that any reasonably possible losses which may be incurred would not be material to the financial statements as a whole.

***Asbestos.*** A wholly-owned subsidiary of the Company, Automotive Specialty Accessories and Parts, Inc. and its wholly-owned subsidiary Whitney Automotive Group, Inc. (referred to as WAG ), are named defendants 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 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.

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. As of the date hereof, the Company believes that the final disposition of such matters will not have a material adverse effect on the financial position, results of operations or cash flow of the Company. The Company maintains liability insurance coverage to protect the Company s assets from losses arising out of or involving activities associated with ongoing and normal business operations.

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**Note 11 Employee Retirement Plan and Deferred Compensation Plan**

Effective February 17, 2006, the Company adopted a 401(k) defined contribution retirement plan covering all full time employees who have completed one month of service. The Company may, at its sole discretion, match fifty cents per dollar up to 6% of each participating employee s salary. The Company s contributions vest in annual installments over three years. Discretionary contributions made by the Company totaled $92,000 and $56,000 during the thirteen weeks ended June 30, 2012 and July 2, 2011, respectively. Discretionary contributions made by the Company totaled $171,000 and $146,000 during the twenty-six weeks ended June 30, 2012 and July 2, 2011, respectively.

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 (employer) as the owner and beneficiary, in order to preserve the tax-deferred savings advantages of a non-qualified plan. The 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 the Company. 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. The Company s contributions vest in annual installments over three years. In September 2010, the Company established and transferred its ownership to a rabbi trust to hold the Company-owned life insurance policies. As of June 30, 2012, the assets and associated liabilities of the Deferred Compensation Plan were $0.7 million and $0.5 million, respectively, and are included in other non-current assets and other non-current liabilities in our consolidated balance sheets. As of December 31, 2011, the assets and associated liabilities of the Deferred Compensation Plan were $0.5 million and $0.4 million and are included in other non-current assets and other non-current liabilities, respectively, in our consolidated balance sheets. As of June 30, 2012, the associated liabilities mainly include the employee contributions of $0.4 million and the Company contributions of $0.1 million. For the thirteen weeks ended June 30, 2012 and July 2, 2011, included in other income, net, the Company recorded a loss of $18,000 and a loss of $3,000, respectively, for the change in the cash surrender value of the Company-owned life insurance policies. For the twenty-six weeks ended June 30, 2012 and July 2, 2011, included in other income, net, the Company recorded a gain of $16,000 and a gain of $9,000, respectively, for the change in the cash surrender value of the Company-owned life insurance policies.

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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 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 December 31, 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 in Part II, Item 1A, 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*, *www.partstrain.com*, *www.jcwhitney.com*, *www.stylintrucks.com*, *www.AutoMD.com* and our corporate website is located at *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 Automotive Specialty Accessories and Parts, Inc. and its wholly-owned subsidiary Whitney Automotive Group, Inc. (referred to herein as WAG ), we expanded our product-lines and increased our customer reach in the do-it-yourself ( DIY ) automobile and off-road accessories market (see *Acquisitions* below). As a result, our business has grown since 2000, generating net sales of $327.1 million for the fiscal year ended December 31, 2011.

*International Operations.* In April 2007, we established offshore operations in the Philippines. Our offshore operations allow us to access a workforce with the necessary technical skills at a significantly lower cost than comparably experienced U.S.-based professionals. Our offshore operations are responsible for a majority of our website development, catalog management and back office support. Our offshore operations also house our main call center. We had 973 employees in the Philippines as of June 30, 2012. In addition to our operations in the Philippines, we have a Canadian subsidiary to facilitate sales of our products in Canada; the subsidiary has no distribution center or employees. We also ship parts directly to Canada and through a freight forwarding partner throughout the world. In fiscal 2011, we shipped auto parts to over 160 different countries. We believe 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 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 Midwest facility expanded our distribution network and the merchandise WAG offers extended 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 increased our customer reach in the DIY automobile and off-road accessories market. 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. Related to the WAG acquisition, the Company incurred acquisition and integration related costs of $7.4 million during the fiscal year ended December 31, 2011. These costs included one-time contract cancellation costs of $1.5 million that the Company recorded in September 2011, for terminating WAG s sublease agreement related to its former corporate offices located in Chicago, Illinois. We have incurred no significant integration costs after fiscal 2011 and none are anticipated going forward. We may pursue additional acquisition opportunities in the future to increase our share of the aftermarket auto parts market or expand our product offerings.

**Executive Summary**

The Company reported net sales for the second quarter ended June 30, 2012 ( Q2 2012 ) of $80.7 million compared with the second quarter ended July 2, 2011 ( Q2 2011 ) net sales of $84.3 million, a decrease of 4.2% from Q2 2011 net sales. Q2 2012 net loss was $1.7 million, or $0.06 per share, compared with Q2 2011 net loss of $2.6 million, or $0.08 per share. The Company generated Adjusted EBITDA (EBITDA plus current period s share-based compensation, loss on debt extinguishment, legal costs to enforce intellectual property rights and restructuring expenses related to acquisition) of $3.7 million for Q2 2012 compared to $4.6 million for Q2 2011, a decrease of 19.5% from Q2 2011. Adjusted EBITDA is presented because such measure is used by rating agencies, securities analysis, investors and other parties in evaluating the Company. It should not be considered, however, as an alternative to operating income as an indicator of the Company s operating performance or as an alternative to cash flows as a measure of the Company s overall liquidity as presented in the Company s consolidated financial statements. Further, the Adjusted EBITDA measure shown for the Company 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 to Adjusted EBITDA for the periods presented (in thousands):

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| Net loss | $ (1,696) | $ (2,564) | $ (2,484) | $ (2,810) |
| Interest expense, net | 183 | 172 | 382 | 437 |
| Income tax provision | 128 | 195 | 252 | 213 |
| Amortization of intangibles | 341 | 1,363 | 681 | 2,990 |
| Depreciation and amortization | 4,001 | 3,072 | 7,748 | 6,075 |
| EBITDA | 2,957 | 2,238 | 6,579 | 6,905 |
| Share-based compensation | 374 | 643 | 958 | 1,324 |
| Loss on debt extinguishment | 360 | | 360 | |
| Legal costs to enforce intellectual property rights | | 161 | | 232 |
| Restructuring costs | | 1,542 | | 2,775 |
| Adjusted EBITDA | $ 3,691 | $ 4,584 | $ 7,897 | $ 11,236 |

**Basis of Presentation**

*Net Sales.* Online and offline sales represent two different sales channels for our products. We generate online net sales primarily through the sale of auto parts to individual consumers through our network of e-commerce websites and online marketplaces, including online advertising. E-commerce sales are derived from our network of websites, which are Company owned and operated. E-commerce and online marketplace sales also include inbound telephone sales through our call center that supports these sales channels. Online marketplaces consist primarily of sales of our products on online auction websites, where we sell through auctions as well as through storefronts that we maintain on these third-party owned websites. We sell advertising and sponsorship positions on our e-commerce websites to highlight vendor brands and offer complementary products and services that benefit our customers. Advertising is targeted to specific sections of the websites and can also be targeted to specific users based on the vehicles they drive. Advertising partners primarily include part vendors, national automotive aftermarket brands and automobile manufacturers. Our offline sales channel represents our distribution of products directly to commercial customers by selling auto parts to collision repair shops located in Southern California and Virginia. Our offline sales channel also includes the distribution of our Kool-Vue mirror line to auto parts distributors nationwide. We also serve consumers by operating retail outlet stores in Independence, Ohio and LaSalle, Illinois.

*Cost of Sales.* Cost of sales consists of the direct costs associated with procuring parts from suppliers and delivering products to customers. These costs include product costs offset by purchase discounts, outbound freight and shipping costs, warehouse supplies and warranty costs. Depreciation and amortization expenses are excluded from cost of sales and included in marketing, general and administrative and fulfillment expenses as noted below.

*Marketing Expense.* Marketing expense consists of online advertising spend, internet commerce facilitator fees and other advertising costs, as well as payroll and related expenses associated with our marketing catalog, customer service and sales personnel. These costs are generally variable and are typically a function of net sales. Marketing expense also includes depreciation and amortization expense and share-based compensation expense.

*General and Administrative Expense.* General and administrative expense consists primarily of administrative payroll and related expenses, payment processing fees, legal and professional fees, amortization of software and other administrative costs. General and administrative expense also includes depreciation and amortization expense and share-based compensation expense.

*Fulfillment Expense*. Fulfillment expense consists primarily of payroll and related costs associated with our warehouse employees and our purchasing group, facilities rent, building maintenance, depreciation and other costs associated with inventory management and our wholesale operations. Fulfillment expense also includes share-based compensation expense.

*Technology Expense.* Technology expense consists primarily of payroll and related expenses of our information technology personnel, the cost of hosting our servers, communications expenses and Internet connectivity costs, computer support and software development. Technology expense also includes share-based compensation expense.

*Amortization of Intangibles*. Amortization of intangibles consists of the amortization expense associated with our definite-lived intangible assets.

*Other Income, net.* Other income, net consists of miscellaneous income or expense such as gains/losses from disposition of assets, and interest income comprised primarily of interest income on investments.

*Interest Expense*. Interest expense consists primarily of interest expense on our outstanding loan balances, deferred financing cost amortization and capital lease interest.

**Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in accordance with U.S. GAAP. The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, net sales, costs and expenses, as well as the disclosure of contingent assets and liabilities and other related disclosures. On an ongoing basis, we evaluate our estimates, including, but not limited to, those related to revenue recognition, uncollectible receivables, the valuation of investments, valuation of inventory, valuation of deferred tax assets and liabilities, valuation of intangible assets including goodwill and other long-lived assets, recoverability of software development costs, share-based compensation expense 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 carrying values of our assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates, and we include any revisions to our estimates in our results for the period in which the actual amounts become known.

Our critical accounting policies are included in *Note 1 Summary of Significant Accounting Policies and Nature of Operations* of the Notes to Consolidated Financial Statements, included above in Part I, Item 1 of this report. There were no significant changes to our critical accounting policies during the twenty-six weeks ended June 30, 2012. We believe our critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our historical consolidated financial condition and results of operations:

- Revenue Recognition;
- Fair Value of Financial Instruments and other Fair Value Measurements;
- Inventory;

- Website and Software Development Costs;
- Long-Lived Assets and Intangibles;
- Goodwill and Indefinite-Lived Intangibles;
- Share-Based Compensation; and
- Income Taxes.

**Recent Accounting Pronouncements**

See *Note 1 Summary of Significant Accounting Policies and Nature of Operations Recent Accounting Pronouncements* of the Notes to Consolidated Financial Statements, included above in Part I, Item 1 of this report.

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**Results of Operations**

The following table sets forth our operating financial data for the periods indicated, expressed as a percentage of net sales:

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| Net sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 69.8 | 66.3 | 69.7 | 65.6 |
| Gross profit | 30.2 | 33.7 | 30.3 | 34.4 |
| Operating expenses: | | | | |
| Marketing | 16.1 | 17.0 | 15.7 | 16.3 |
| General and administrative | 5.8 | 10.0 | 6.3 | 9.7 |
| Fulfillment | 7.0 | 5.4 | 6.9 | 5.6 |
| Technology | 2.1 | 2.3 | 1.9 | 2.3 |
| Amortization of intangibles | 0.4 | 1.6 | 0.4 | 1.7 |
| Total operating expenses | 31.4 | 36.3 | 31.2 | 35.6 |
| Loss from operations | (1.2) | (2.6) | (0.9) | (1.2) |
| Other income (expense): | | | | |
| Other income, net | | | | |
| Interest expense | (0.2) | (0.2) | (0.2) | (0.3) |
| Loss on debt extinguishment | (0.5) | | (0.2) | |
| Total other expense | (0.7) | (0.2) | (0.4) | (0.3) |
| Loss before income taxes | (1.9) | (2.8) | (1.3) | (1.5) |
| Income tax provision | 0.2 | 0.2 | 0.2 | 0.1 |
| Net loss | (2.1)% | (3.0)% | (1.5)% | (1.6)% |

***Thirteen and Twenty-Six Weeks Ended June 30, 2012 Compared to the Thirteen and Twenty-Six Weeks Ended July 2, 2011***

*Net Sales and Gross Margin*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| Net sales | $ 80,719 | $ 84,268 | $ 168,155 | $ 171,246 |
| Cost of sales | 56,378 | 55,854 | 117,186 | 112,416 |
| Gross profit | $ 24,341 | $ 28,414 | $ 50,969 | $ 58,830 |
| Gross margin | 30.2% | 33.7% | 30.3% | 34.4% |

Net sales decreased $3.5 million, or 4.2%, for Q2 2012 compared to Q2 2011. Our Q2 2012 net sales consisted of online sales, representing 92.5% of the total (compared to 94.4% in Q2 2011) and offline sales, representing 7.5% of the total (compared to 5.6% in Q2 2011). The net sales decrease was primarily due to a decline of $4.9 million, or 6.1%, in online sales offset by a $1.3 million, or 28.1% increase in offline sales. Online sales decreased primarily due to a 6% reduction in e-commerce unique visitors and a decline in average order value by 7%, partially offset by a 1% improvement in conversion and an increase of 1% in revenue capture. Our online sales consist of our e-commerce, online marketplace sales channels and online advertising. Our e-commerce channel includes our e-commerce websites supported by our call-center sales agents who generate cross-sell and up-sell opportunities. Our online marketplaces consist primarily of auction and other third-party websites. Online advertising is sold on our e-commerce websites. Our offline sales, which consist of our Kool-Vue and wholesale operations, continued to show solid growth.

Net sales decreased $3.1 million, or 1.8%, for the twenty-six weeks ended June 30, 2012 ( YTD Q2 2012 ), compared to the twenty-six weeks ended July 2, 2011 ( YTD Q2 2011 ). Our YTD Q2 2012 net sales consisted of online sales, representing 93.0% of the total (compared to 94.1% in 2011) and offline sales, representing 7.0% of the total (compared to 5.9% in 2011). The net sales decrease was primarily due to an $11.4 million, or 8.0%, decrease in e-commerce sales, which resulted from a lower conversion, revenue capture and average order value.

Gross profit decreased $4.1 million, or 14.3%, in Q2 2012 compared to Q2 2011. Gross margin declined 3.5% to 30.2% in Q2 2012 compared to 33.7% in Q2 2011. For YTD Q2 2012, gross profit decreased $7.9 million, or 13.4%, compared to YTD Q2 2011. Gross margin declined 4.1% to 30.3% in YTD Q2 2012 compared to 34.4% in YTD Q2 2011. Gross margin was unfavorably impacted by increased competition in the marketplace and higher freight expenses for the thirteen and twenty-six weeks ended June 30, 2012.

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*Marketing Expense*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| Marketing expense | $ 12,978 | $ 14,366 | $ 26,428 | $ 27,951 |
| Percent of net sales | 16.1% | 17.0% | 15.7% | 16.3% |

Total marketing expense decreased $1.4 million, or 9.7%, for Q2 2012 compared to Q2 2011. Online advertising expense, which includes catalog costs, was $5.2 million or 7.0% of online sales for Q2 2012, compared to $7.6 million, or 9.6%, of online sales for Q2 2011. Marketing expense, excluding online advertising, was $7.7 million, or 9.6%, of net sales for Q2 2012, compared to $6.8 million, or 8.0%, of net sales for Q2 2011. Online advertising expense decreased primarily due to reduced catalog advertising costs of $1.3 million, and our non-catalog online advertising expenses (including listing and placement fees paid to commercial and search engine websites) also decreased by $1.1 million due to lower sales volume. Marketing expenses, excluding online advertising, increased primarily due to higher amortization costs related to software deployments.

Total marketing expense decreased $1.5 million, or 5.4%, for YTD Q2 2012 compared to YTD Q2 2011. Online advertising expense, which includes catalog costs, was $11.3 million, or 7.2%, of online sales for YTD Q2 2012, compared to $14.7 million, or 9.3%, of online sales for YTD Q2 2011. Marketing expense, excluding online advertising, was $15.1 million, or 9.0%, of net sales for YTD Q2 2012, compared to $13.2 million, or 7.7%, of net sales for YTD Q2 2011. Online advertising expense decreased primarily due to reduced catalog advertising costs of $2.3 million, and our more substantial non-catalog online adverting expenses (including listing and placement fees paid to commercial and search engine websites) decreased by $1.1 million. Marketing expenses, excluding online advertising, increased primarily due to higher amortization costs related to software deployments.

*General and Administrative Expense*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| General and administrative expense | $ 4,714 | $ 8,407 | $ 10,584 | $ 16,643 |
| Percent of net sales | 5.8% | 10.0% | 6.3% | 9.7% |

General and administrative expense decreased $3.7 million, or 43.9%, and $6.1 million, or 36.4%, for Q2 2012 and YTD Q2 2012, compared to Q2 2011 and YTD Q2 2011, respectively. The decreases were primarily due to $1.5 million and $2.8 million in WAG restructuring costs during Q2 2011 and YTD Q2 2011, respectively, compared to none in fiscal 2012. Additionally, lower depreciation and amortization expense, payroll expenses and share-based compensation in fiscal 2012 contributed to the decreases.

*Fulfillment Expense*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| Fulfillment expense | $ 5,639 | $ 4,592 | $ 11,557 | $ 9,599 |
| Percent of net sales | 7.0% | 5.4% | 6.9% | 5.6% |

Fulfillment expense increased $1.0 million, or 22.8%, and $2.0 million, or 20.4%, for Q2 2012 and YTD Q2 2012, compared to Q2 2011 and YTD Q2 2011, respectively. The increase was primarily due to higher depreciation and amortization expense from software deployments and higher payroll expenses.

*Technology Expense*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| Technology expense | $ 1,700 | $ 1,917 | $ 3,236 | $ 3,855 |
| Percent of net sales | 2.1% | 2.3% | 1.9% | 2.3% |

Technology expense decreased $0.2 million, or 11.3%, and $0.6 million, or 16.1%, for Q2 2012 and YTD Q2 2012, compared to Q2 2011 and YTD Q2 2011, respectively. The decrease was primarily due to lower telephone, consulting and computer support expenses.

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*Amortization of Intangibles*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| Amortization of Intangibles | $ 341 | $ 1,363 | $ 681 | $ 2,990 |
| Percent of net sales | 0.4% | 1.6% | 0.4% | 1.7% |

Amortization of intangibles decreased by $1.0 million, or 75.0%, and $2.3 million, or 77.2%, for Q2 2012 and YTD Q2 2012, compared to Q2 2011 and YTD Q2 2011, respectively. The decrease is primarily due to certain acquired intangibles that were fully amortized during fiscal 2011.

*Total Other Expense, Net*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| Total other expense, net | $ (537) | $ (138) | $ (715) | $ (389) |
| Percent of net sales | (0.7)% | (0.2)% | (0.4)% | (0.2)% |

Total other expense, net increased $0.4 million, or 289.1%, and $0.3 million, or 83.8%, for Q2 2012 and YTD Q2 2012, compared to Q2 2011 and YTD Q2 2011, respectively, primarily due to the recognized loss on debt extinguishment of $360,000 (refer to additional information in *Note 6 Borrowings* of the Notes to Consolidated Financial Statements, included above in Part I, Item 1 of this report).

*Income Tax Provision*

| | Thirteen Weeks Ended | | Twenty-Six Weeks Ended | |
|---|---|---|---|---|
| | June 30, 2012 | July 2, 2011 | June 30, 2012 | July 2, 2011 |
| | (in thousands) | | | |
| Income tax provision | $ 128 | $ 195 | $ 252 | $ 213 |
| Percent of net sales | 0.2% | 0.2% | 0.2% | 0.1% |

For Q2 2012 and Q2 2011, our effective tax rate was (8.2)% and (8.2)%, respectively. Additionally, for YTD Q2 2012 and YTD Q2 2011, our effective tax rate was (11.2)% and (8.2)%, respectively. The Company s effective tax rate for the thirteen and twenty-six weeks ended June 30, 2012 differed from the U.S. federal statutory rate primarily as a result of the recording of valuation allowance against the pre-tax losses and the increase in deferred tax liabilities related to tax deductible indefinite-lived intangible assets, as well as tax expense incurred outside of the U.S. 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 as a result of the recording of valuation allowance against pre-tax losses and the increase in deferred tax liabilities related to tax deductible indefinite-lived intangible assets. As of June 30, 2012, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters.

*Foreign Currency*

The impact of foreign currency is related to our offshore operations in the Philippines and sales of our products in Canada and was not material to our operations. See additional information in *Foreign Currency Risk* below in Item 3.

**Liquidity and Capital Resources**

*Sources of Liquidity*

During the twenty-six weeks ended June 30, 2012, we funded our operations with cash and cash equivalents generated from operations, short-term investments and our credit facility. We had cash and cash equivalents of $1.4 million as of June 30, 2012, representing an $8.8 million decrease from $10.3 million of cash and cash equivalents as of December 31, 2011. The decrease in cash and cash equivalents was primarily due to payments on accounts payable, capital expenditures and net payments on debt, partially offset by positive cash flows from other working capital sources and net proceeds from sales of our investments. As of June 30, 2012, we had $96,000 in short-term investments, comprised of mutual funds (refer to investment details in *Note 2 Investments* of the Notes to Consolidated Financial Statements, included above in Part I, Item 1 of this report). Our April 2012 credit facility provides for a revolving commitment of up to $40 million (see *Debt and Available Borrowing Resources* below).

In May 2011, we filed a shelf registration statement covering the offer and sale of up to $200 million of common stock with the SEC. The shelf registration was declared effective by the SEC on August 10, 2011. 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.

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*Working Capital*

As of June 30, 2012 and December 31, 2011, our working capital was $0.6 million and $8.7 million, respectively. The decrease in reported working capital as of June 30, 2012 is primarily the result of the current classification of our $12.9 million loan balance under our credit facility. Our credit facility consists of a five-year revolving loan with available funds of up to $40 million, which will provide for our working capital requirements as needed going forward (see further discussion in *Debt and Available Borrowing Resources* below). Our revolving loan does not require principal payments, however is classified as current due to certain accounting requirements. Giving consideration to our current liquidity position, excluding our loan balance of $12.9 million, our adjusted working capital was $13.5 million as of June 30, 2012. The adjusted working capital figure is a non-GAAP financial measure, as defined by the SEC, which provides a more complete understanding of factors and trends affecting our business and financial position as of June 30, 2012. The historical seasonality in our business during the year can cause cash and cash equivalents, inventory and accounts payable to fluctuate, resulting in changes in our working capital.

*Cash Flows*

The following table summarizes the key cash flow metrics from our consolidated statements of cash flow for the twenty-six weeks ended June 30, 2012 and July 2, 2011:

| | Twenty-Six Weeks Ended | |
|---|---|---|
| | **June 30, 2012** | **July 2, 2011** |
| Net cash (used in) provided by operating activities | $ (1,665) | $ 7,421 |
| Net cash used in investing activities | (2,378) | (6,057) |
| Net cash used in financing activities | (4,901) | (2,720) |
| Effect of exchange rate changes on cash | 14 | 10 |
| Net change in cash and cash equivalents | $ (8,930) | $ (1,346) |

*Operating Activities*

For the twenty-six weeks ended June 30, 2012, net cash used in operating activities was primarily the result of the following significant items: net loss ($2.5 million), which was offset by adjustments for non-cash items (totaling $10.1 million) such as depreciation and amortization ($8.4 million) and share-based compensation ($1.0 million); and negative net working capital activity (totaling $9.3 million) such as payments on accounts payable (resulting in a net decrease in accounts payable of $4.7 million), cash used for other payables and accrued expenses ($3.3 million), cash used for other liabilities ($2.4 million) and an increase in accounts receivable ($1.6 million), partially offset by a decrease in inventory ($3.0 million).

For the twenty-six weeks ended July 2, 2011, the net cash provided by operating activities was primarily the result of the following significant items: net loss ($2.8 million), which was offset by adjustments for non-cash items (totaling $10.7 million) such as depreciation and amortization ($9.1 million) and share-based compensation ($1.3 million); and negative net working capital activity (totaling $0.4 million) such as an increase in accounts receivable ($2.0 million), partially offset by a decrease in inventory ($2.3 million).

*Investing Activities*

For the twenty-six weeks ended June 30, 2012, net cash used in investing activities was primarily the result of purchasing property and equipment ($5.4 million), partially offset from net proceeds received from sales of our investments ($3.2 million).

For the twenty-six weeks ended July 2, 2011, net cash used in investing activities was primarily the result of purchasing property and equipment ($7.2 million).

*Financing Activities*

For the twenty-six weeks ended June 30, 2012, net cash used in financing activities was primarily the result of payments made on debt, totaling $21.6 million, which included the payoff of our previous term loan balance of $17.9 million and payments on our new revolving loan of $3.7 million, partially offset by the proceeds received from our new revolving loan of $16.6 million (see further discussion in *Debt and Available*

*Borrowing Resources* below).

For the twenty-six weeks ended July 2, 2011, net cash used in financing activities was primarily the result of payments made on debt ($3.0 million), partially offset by proceeds received from the exercise of stock options ($0.3 million).

*Debt and Available Borrowing Resources*

Total debt, comprised of a bank loan ($12.9 million, discussed further below) and a capital lease payable ($0.2 million), was $13.1 million as of June 30, 2012, compared to $18.1 million as of December 31, 2011. The decrease is due to net debt payments of $5.0 million made during the twenty-six weeks ended June 30, 2012. Our April 2012 credit facility provides for a revolving commitment of up to $40 million (discussed further below) and will allow the Company to obtain short-term and long-term financings if we need additional liquidity. Additionally, the new credit facility provides lower interest rate options and interest-only payments.

Our debt-equity ratio is calculated as the carrying value of debt divided by the carrying value of equity. As of June 30, 2012 and December 31, 2011, our debt-equity ratio was 0.22 and 0.30, respectively.

As further discussed in *Note 6 Borrowings* of the Notes to Consolidated Financial Statements included above in Part I, Item 1 of this report, in August 2010, the Company executed a Loan Agreement and other definitive documentation for a $35 million secured credit facility. The facility was 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 Company had no borrowings on the revolving line of credit. The remaining term loan balance was $17.9 million as of March 31, 2012 and was scheduled for repayment through June 2014. The facility was repaid in full in April 2012 with a revolving loan arrangement.

On April 26, 2012, the Company, certain of its wholly-owned domestic subsidiaries and JPMorgan Chase Bank, N.A., as sole lender and administrative agent entered into a Credit Agreement, dated as of April 26, 2012. The Credit Agreement provides for a revolving commitment in an aggregate principal amount of up to $40,000,000 (Credit Facility), which is subject to a borrowing base derived from certain receivables, inventory, property and pledged cash. The Credit Facility matures on April 26, 2017. The Company used the proceeds of the loans borrowed on the closing date to repay in full its previous credit facility with Silicon Valley Bank. In connection with the payoff of our previous credit facility, the Company recorded a loss on debt extinguishment of $360,000 which was comprised of a prepayment fee in the amount of $166,000, accelerated deferred financing costs in the amount of $185,000 and other direct expenses related to the previous debt. At June 30, 2012, our outstanding revolving loan balance was $12.9 million. The customary events of default under the Credit Facility include certain subjective acceleration clauses, which management has determined the likelihood of such acceleration is more than remote, considering the recurring losses experienced by the Company, therefore a current classification of our long-term loan balance was required as of June 30, 2012.

Loans drawn under the Credit Facility bear interest, at the Company s option, at a per annum rate equal to either (a) LIBOR plus an applicable margin of 1.50%, or (b) an alternate base rate minus an applicable margin of 0.50%. Each applicable margin as set forth in the prior sentence is subject to increase or decrease by 0.25% per annum based upon the Company s fixed charge coverage ratio. At June 30, 2012, the Company s LIBOR based interest rate was 1.75% (on $10.0 million principal) and the Company s Prime based rate was 2.75% (on $2.9 million principal). The Company made no loan draws under the Credit Facility as of June 30, 2012; however in July 2012, the Company borrowed a total of $5.5 million with interest currently at 2.75% (Prime minus 0.50%). Interest-only payments are currently due monthly. A commitment fee, based upon undrawn availability under the Credit Facility bearing interest at a rate of 0.20% per annum, is payable monthly. Under the terms of the Credit Agreement, cash receipts are deposited into a lock-box, which are at the Company s discretion unless the cash dominion period is in effect, during which cash receipts will be used to reduce amounts owing under the Credit Agreement. The cash dominion period is triggered in an event of default or if excess availability is less than $6,000,000 at any time, as defined, and will continue until, during the preceding 60 consecutive days, no event of default existed and excess availability has been greater than $7,000,000 at all times. The Company s excess availability was $14.9 million at June 30, 2012. As of the date hereof, the cash dominion period has not been in effect; accordingly no principal payments are currently due. By amendment to the Credit Agreement, the Company also has the right to request increases to the revolving commitments up to and above $60,000,000. See additional information in *Note 6 Borrowings* of the Notes to Consolidated Financial Statements included above in Part I, Item 1 of this report.

As of June 30, 2012, the Company had a capital lease obligation of $208,000.

*Funding Requirements*

We anticipate that funds generated from operations, cash on hand, short-term investments and if needed, borrowings under our Credit Facility, will be sufficient to meet our working capital needs and expected capital expenditures, continue our technology investments in an effort to improve our websites, operating systems and backend platforms, and continue the servicing of our Credit Facility, for at least the next twelve months. As discussed above, our new Credit Facility provides a less restrictive asset-based funding limit and interest-only payment requirements, which gives us improved liquidity options at a lower cost of capital, if and when needed. 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 may cause us to seek additional debt or equity financings in the future. We may need to issue common stock under our shelf registration, discussed above. 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.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

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**Contractual Obligations**

The following table sets forth our contractual cash obligations and commercial commitments as of June 30, 2012:

| | Payment Due By Period (in thousands) | | | | |
|---|---|---|---|---|---|
| **Contractual Obligations:** | **Total** | **Less than 1 year** | **1-3 years** | **3-5 years** | **More than 5 years** |
| Principal payments on debt (1) | $ 12,908 | $ | $ | $ 12,908 | $ |
| Interest payments on debt (2) | 1,229 | 128 | 765 | 336 | |
| Operating lease obligations (3) | 5,313 | 1,809 | 2,257 | 1,247 | |
| Capital lease obligations (4) | 219 | 128 | 51 | 40 | |

(1) Amounts represent the expected principal cash payments relating to our debt and do not include any fair value adjustments or discounts and premiums. Our outstanding debt is comprised of a revolving loan which currently has no principal payment requirements, and matures in April 2017. See additional information in *Liquidity and Capital Resources Debt and Available Borrowing Resources* above.

(2) Amounts represent the expected interest cash payments relating to our revolving loan balance at June 30, 2012. The interest rates at June 30, 2012 were used to calculate the expected future interest payments.

(3) Commitments under operating leases relate primarily to our leases on our principal facility in Carson, California, our distribution centers in Chesapeake, Virginia and Independence, Ohio, and our call center in the Philippines. Total operating lease commitments include payments due to a related party for one of our facilities leases in the amount of $343,000.

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

**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 year.

**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. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We do not have any derivative financial instruments. 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.

*Interest Rate Risk.* Our investment securities generally consist of mutual funds and other high-grade securities. As of June 30, 2012, our investments were comprised of $96,000 of investments in mutual funds that primarily hold debt securities. During the twenty-six months ended June 30, 2012, the Company fully redeemed its remaining ARPS investments. During the various ARPS holding periods, the Company earned the stated rate of interest and incurred no realized losses (refer to investment details in *Note 3 Fair Value Measurements* of the Notes to Consolidated Financial Statements, included above in Part I, Item 1 of this report).

As of June 30, 2012, we had a balance of $12.9 million outstanding under a revolving loan under our credit facility. The interest rate on this loan is computed based on a LIBOR and Prime loan rate, adjusted by features specified in our loan agreement. At our debt level as of June 30, 2012, 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. At June 30, 2012, our LIBOR based interest rate was 1.75% per annum (on $10.0 million principal) and our Prime based rate was 2.75% per annum (on $2.9 million principal). Refer to additional discussion above in Item 2, under the caption *Liquidity and Capital Resources* *Debt and Available Borrowing Resources* .

*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, a fluctuation of 10% in the Peso/U.S. dollar exchange rate would have approximately a $0.7 million impact on our Philippine operating expenses for the twenty-six weeks ended June 30, 2012. 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.

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 Chief Executive Officer and Chief Financial Officer 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 the caption *Legal Matters* in *Note 10 Commitments and Contingencies* of the Notes to 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 26, 2012. 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,

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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 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.

***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;
- 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.

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., 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, 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, during the fiscal year ended December 31, 2011, we incurred acquisition and integration related costs of $7.4 million and recorded a non-cash impairment charge on certain trade name intangible assets totaling $5.1 million. During the twenty-six weeks ended June 30, 2012, we incurred no acquisition and integration related costs and no related impairment charges were recorded during the period then ended.

***Our operations are restricted by our credit facility, and our ability to borrow funds under our credit facility is subject to a borrowing base.***

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;
- 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;

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- guarantee the debts of others;
- enter into new lines of business;
- pay or amend our subordinated debt;
- form any joint ventures or subsidiary investments.

In addition, our credit facility is subject to a borrowing base derived from certain of our receivables, inventory, property and pledged cash. In the event that components of the borrowing base are adversely affected for any reason, including adverse market conditions or downturns in general economic conditions, we could be restricted in the amount of funds we can borrow under the credit facility. Furthermore, in the event that components of the borrowing base decrease to a level below the amount of loans then-outstanding under the credit facility, we could be required to immediately repay loans to the extent of such shortfall. If any of these events were to occur, it could severely impact our liquidity and capital resources, limit our ability to operate our business and could have a material adverse effect on our financial condition and results of operations.

Furthermore, our 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. In the future, 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 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; and
- 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 international business operations in the Philippines. This international operation includes development and maintenance of our websites, our main call center, and sales and back office 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;
- 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 45.5% of our total product purchases during the twenty-six weeks ended June 30, 2012. 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 June 30, 2012, our product purchases from two drop-ship suppliers represented 19.7% of our total product purchases. If we do not maintain our existing relationships with these suppliers 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.

***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.

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***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. 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 original equipment manufacturer ( OEM ) and aftermarket auto parts to either the DIY 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 and auto repair information websites;
- 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.

***Challenges by 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.***

OEMs 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 approximately 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 related to claims of intellectual property infringement. The United States Patent and Trademark Office records indicate that OEMs are seeking and obtaining more design patents then 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 several 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* , *www.autopartswarehouse.com* , *www.partstrain.com* , *www.jcwhitney.com* , *www.AutoMD.com* and *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.

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***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.

***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.

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.

**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 through June 30, 2012, 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 June 30, 2012, our executive officers and directors and entities that are affiliated with them beneficially owned in the aggregate approximately 46.7% 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;

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- 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;

- 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 continue to be effective as of June 30, 2012 (since management assessed the effectiveness as of December 31, 2011), we have in the past, and could in the future, have a significant deficiency or material weakness 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 2 /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.

***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, Virginia, 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.

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.

***Security threats to our IT infrastructure could expose us to liability, and damage our reputation and business***

It is essential to our business strategy that our technology and network infrastructure remain secure and is perceived by our customers to be secure. Despite security measures, however, any network infrastructure may be vulnerable to cyber-attacks by hackers and other security threats. As a leading online source for automotive aftermarket parts and repair information, we may face cyber-attacks that attempt to penetrate our network security, including our data centers, to sabotage or otherwise disable our network of websites and online marketplaces, misappropriate our or our customers proprietary information, which may include personally identifiable information, or cause interruptions of our internal systems and services. If successful, any of these attacks could negatively affect our reputation, damage our network infrastructure and our ability to sell our products, harm our relationship with customers that are affected and expose us to financial liability.

***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.

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***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. 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 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. Mine Safety Disclosures**

Not applicable.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

The following exhibits are filed herewith or incorporated by reference to the location indicated below:

| Exhibit No. | Description |
|---|---|
| 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 |
| 10.77 | Credit Agreement, dated April 26, 2012, by and between U.S. Auto Parts Network, Inc., certain of its wholly-owned domestic subsidiaries and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 30, 2012) |
| 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.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.

\+ Indicates a management contract or compensatory plan or arrangement

¿ 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 Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 7, 2012

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

By: /s/ Shane Evangelist
Shane Evangelist
Chief Executive Officer
(Principal Executive Officer)

By: /s/ David Robson
David Robson
Chief Financial Officer
(Principal Financial and Accounting Officer)