U.S. Auto Parts Network, Inc.
Form 10-Q
August 17, 2010
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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 July 3, 2010

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.)**

17150 South Margay Avenue

Carson, CA 90746

(Address of Principal Executive Office) (Zip Code)

(310) 735-0085

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 ¨ 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. (Check one):

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

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 16, 2010, the registrant had 30,357,478 shares of common stock, $0.001 par value, outstanding.

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U.S. AUTO PARTS NETWORK, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE THIRTEEN AND TWENTY-SIX WEEKS ENDED JULY 3, 2010

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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 , and JC Whitney® 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

This report contains statements that do not relate strictly to historical or current facts, and anticipate results based on management s beliefs and assumptions and on information currently available to management. These statements are forward looking statements for the purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 27A of the Securities Act of 1933 (the Securities Act). In some cases, you can identify forward-looking statements by terms such as anticipates, believes, could, estimates, expects, intends, may, plans, potential, predicts, projects, should, will, would, will likely continue, will likely result and similar expressions intended to identify forward-looking statements. These forward-looking statements include but are not limited to statements regarding our anticipated sales, revenue, expenses, profits and losses, capital needs, capital deployment, liquidity, contracts, litigation, product offerings, customers, acquisitions, competition and the status of our facilities. Forward-looking statements, no matter where they occur in this document or in other statements attributable to the Company, involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. We discuss many of these risks in greater detail under the heading Risk Factors in Part II, Item 1A of this report. Given these uncertainties, you should not place undue reliance on these forward-looking statements. You should read this report and the documents that we reference in this report or 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 (Unaudited)

U.S. AUTO PARTS NETWORK, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts and par value)

	July 3, 2010	January 2, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,197	$ 26,251
Short-term investments	24,983	11,071
Accounts receivable, net	2,581	3,383
Inventory	26,536	18,610
Deferred income taxes	1,513	1,513
Other current assets	4,013	3,148
Total current assets	74,823	63,976
Property and equipment, net	14,920	12,405
Intangible assets, net	3,870	3,114
Goodwill	9,772	9,772
Deferred income taxes	10,065	10,985
Investments	4,165	4,264
Other non-current assets	435	98
Total assets	$ 118,050	$ 104,614
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 17,173	$ 11,371
Accrued expenses	9,623	8,038
Other current liabilities	3,736	2,518
Total current liabilities	30,532	21,927
Other non-current liabilities	317	
Total liabilities	30,849	21,927
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.001 par value; 100,000,000 shares authorized at July 3, 2010 and January 2, 2010; 30,336,020 and 29,893,631 shares issued and outstanding at July 3, 2010 and January 2, 2010, respectively	30	30
Additional paid-in capital	152,510	150,084
Accumulated other comprehensive income	163	84
Accumulated deficit	(65,502)	(67,511)
Total stockholders equity	87,201	82,687

Total liabilities and stockholders equity	$ 118,050	$ 104,614

See accompanying notes to unaudited condensed consolidated financial statements.

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U.S. AUTO PARTS NETWORK, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share amounts)

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
Net sales	$ 53,188	$ 43,805	$ 109,479	$ 83,469
Cost of sales	34,791	27,937	71,275	52,961
Gross profit	18,397	15,868	38,204	30,508
Operating expenses:				
Marketing [(1)]	7,138	5,680	14,351	11,015
General and administrative [(1)]	6,395	4,811	12,132	9,576
Fulfillment [(1)]	2,924	2,809	6,167	5,461
Technology [(1)]	1,158	1,343	2,176	2,271
Amortization of intangibles	124	153	245	520
Total operating expenses	17,739	14,796	35,071	28,843
Income from operations	658	1,072	3,133	1,665
Other income (expense):				
Other expense	(5)	(23)	(4)	(23)
Interest income, net	34	49	55	140
Total other income, net	29	26	51	117
Income before income taxes	687	1,098	3,184	1,782
Income tax provision	225	469	1,175	1,832
Net income (loss)	$ 462	$ 629	$ 2,009	$ (50)
Basic net income (loss) per share	$ 0.02	$ 0.02	$ 0.07	$ (0.00)
Diluted net income (loss) per share	$ 0.01	$ 0.02	$ 0.06	$ (0.00)
Shares used in computation of basic net income (loss) per share	30,314,478	29,846,757	30,158,797	29,846,757
Shares used in computation of diluted net income (loss) per share	31,994,447	30,395,189	31,723,316	29,846,757

(1) Includes share-based compensation expense as follows :

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009

Marketing	$ 72	$ 110	$ 192	$ 216
General and administrative	452	495	1,000	1,317
Fulfillment	64	57	189	104
Technology	24	158	91	210
Total share-based compensation expense	$ 612	$ 820	$ 1,472	$ 1,847

See accompanying notes to unaudited condensed consolidated financial statements.

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U.S. AUTO PARTS NETWORK, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
Operating activities		
Net income (loss)	$ 2,009	$ (50)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,934	2,153
Amortization of intangibles	245	520
Share-based compensation expense	1,472	1,847
Excess tax benefits from share-based payment arrangements	(237)	
Deferred taxes	790	1,731
Changes in operating assets and liabilities:		
Accounts receivable, net	802	(511)
Inventory	(7,926)	(1,274)
Other current assets	(865)	(1,044)
Other non-current assets	(81)	
Accounts payable and accrued expenses	7,639	3,267
Other current liabilities	1,218	925
Other non-current liabilities	317	
Net cash provided by operating activities	9,317	7,564
Investing activities		
Additions to property and equipment	(6,293)	(3,862)
Proceeds from sale of investments	4,236	475
Purchases of investments	(17,984)	(4,096)
Purchases of company-owned life insurance	(250)	
Purchases of intangible assets	(1,001)	
Net cash used in investing activities	(21,292)	(7,483)
Financing activities		
Payments on short-term financing		(39)
Proceeds from exercise of stock options	658	
Excess tax benefits from share-based payment arrangements	237	
Net cash provided by (used in) financing activities	895	(39)
Effect of changes in foreign currencies	26	82
Net (decrease) increase in cash and cash equivalents	(11,054)	124
Cash and cash equivalents at beginning of period	26,251	32,473
Cash and cash equivalents at end of period	$ 15,197	$ 32,597

Supplemental disclosure of non-cash investing activities:

Accrued asset purchases	$	571	$	75
Cash paid during the period for income taxes	$	87	$	

See accompanying notes to unaudited condensed consolidated financial statements.

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements of U.S. Auto Parts Network Inc. (USAP and collectively with its subsidiaries, the Company) have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to U.S. Securities and Exchange Commission (SEC) Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of July 3, 2010 and January 2, 2010, and the consolidated results of operations for the thirteen and twenty-six weeks ended July 3, 2010 and July 4, 2009, and cash flows for the twenty-six weeks ended July 3, 2010 and July 4, 2009. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. The Company s results of operations for the thirteen and twenty-six weeks ended July 3, 2010 are not necessarily indicative of those to be expected for the entire 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 January 2, 2010 (fiscal 2009), which was filed with the SEC on March 15, 2010.

Change in Fiscal Year

The Company s fiscal year is based on a 52/53 week fiscal year ending on the first Saturday following December 31. The change in the Company s reporting year from a calendar year to a 52/53 week fiscal year was disclosed and effective as of January 1, 2009; therefore, there was no transition period in connection with this change in the Company s fiscal year end.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, but are not limited to, the valuation of investments, the valuation of inventory, valuation of deferred tax assets and liabilities, estimated useful lives of property, equipment and software, valuation of intangible assets, including goodwill, recoverability of software development costs, estimation of sales returns and allowances, and the provision for doubtful accounts. These estimates are based on current facts, historical experience and various other factors that the Company believes to be reasonable under the circumstances. Actual results could differ from these estimates.

Revenue Recognition

From the Company s inception of business through the first quarter of the fiscal year ending January 1, 2011 (fiscal 2010), the Company recognized revenue from product sales when the following four revenue recognition criteria were met: persuasive evidence of an arrangement exists, delivery has occurred (to the common carrier), the selling price is fixed or determinable, and collectability is reasonably assured. These criteria followed the Company s general policy to recognize revenue according to its shipping terms, which were F.O.B. shipping point. Under this policy, title and risk of loss were transferred to the customer upon delivery to the common carrier, at which time, revenue was recognized.

Although the Company had no legal obligation to compensate the customer, the Company generally replaced the product or reimbursed the customer for goods that were lost or damaged in transit and filed a claim to the common carrier for reimbursement for such loss. The Company executed a new pricing agreement with its primary carrier which offered a lower price per delivery and eliminated the Company s option to file reimbursement claims for product lost or damaged in transit. As a result of this agreement, the Company determined that the risk of loss or damage during transit would be retained by the Company. Therefore, to be in conformity with the new freight contract terms, the Company determined that revenue from product sales should be recognized at the delivery date, not the ship date.

This change in the second quarter of fiscal 2010 resulted in a deferral of $2.0 million of sales revenue and a decrease in cost of goods sold of $1.5 million, which reduced gross margin profit by $0.5 million. Prospectively, the Company will recognize revenue upon delivery to the customer.

Revenue from sales of advertising is recorded when performance requirements of the related advertising program agreement are met. For the twenty-six weeks ended July 3, 2010, the advertising revenue represented 1% of our total revenue.

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2 Investments

As of July 3, 2010, the Company held the following securities and investments, recorded at fair value (in thousands).

	Amortized Cost	Unamortized / Unrealized Gains	Unamortized / Unrealized Losses	Fair Value / Carrying Value
Auction rate preferred securities in municipal and state agencies	$ 4,225	$	$ (60)	$ 4,165
Certificates of deposit, bonds, and mutual funds	24,963	20		24,983
Total	$ 29,188	$ 20	$ (60)	$ 29,148

Fair Value Measurements

In April 2009, the Financial Accounting Standards Board (FASB) released ASC 820, *Fair Value Measurements and Disclosures,* that defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. This guideline was to be effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB delayed the effective date to fiscal years beginning after November 15, 2008 for all non-financial assets and non-financial liabilities, except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis. As of January 1, 2009, the Company has adopted the provisions of ASC 820 for all non-financial assets and non-financial liabilities.

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

Level 1 - defined as observable inputs such as quoted prices in active markets;

Level 2 - defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and

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

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial Assets Valued on a Recurring Basis

As of July 3, 2010, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company s financial instruments, including investments associated with the auction rate preferred securities (ARPS). The Company measures the following financial assets at fair value on a recurring basis. The fair value of these financial assets was determined using the following inputs at July 3, 2010 and January 2, 2010 (in thousands):

	As of July 3, 2010			
	Total	Level 1	Level 2	Level 3
Assets:				
Short-term investment [1]	$ 24,983	$ 24,983	$	$
Non-current investments available-for-sale [2]	4,165			4,165
	$ 29,148	$ 24,983	$	$ 4,165

	As of January 2, 2010			
	Total	Level 1	Level 2	Level 3
Assets:				
Short-term investment [1]	$ 6,965	$ 6,965	$	$
Non-current investments available-for-sale [2]	4,264			4,264
	$ 11,229	$ 6,965	$	$ 4,264

(1) Short-term investments consist of municipal bonds, corporate bonds, certificates of deposit, and mutual funds. Short-term investments are classified as investments available-for-sale and recorded at fair market value, based on quoted prices of identical assets that are trading in active markets as of the end of the period for which the values are determined.

(2) As of July 3, 2010, the Company had invested $4.2 million (par value) in ARPS, which are classified as available-for-sale securities and reflected at $4.2 million (fair value), which includes an unrealized loss of $0.1 million. The Company has included its investments related to ARPS in the Level 3 category.

Before utilizing Level 3 inputs in our fair value measurement, the Company considered significant Level 2 observable inputs of similar assets in active and inactive markets. The Company s broker dealer received estimated market values from an independent pricing service as of the balance sheet date and the anticipated future market for such investments. Further evidence includes the fact that these investments consist solely of collateralized debt obligations supported by municipal and state agencies; do not include mortgage-backed securities or student loans; have redemption features that call for redemption at 100% of par value; and have a current credit rating of A or AAA. However, the fact that there is not an active market to liquidate these investments was considered in classifying them as Level 3. Due to the uncertainty with regard to the short-term liquidity of these securities, the Company determined that it could not rely on par value to represent fair value. Therefore, the Company estimated the fair values of these securities utilizing a discounted cash flow valuation model as of July 3, 2010. This analysis considered the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation the security will have a successful auction or market liquidity. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company.

As a result of the temporary declines in fair value for the Company s ARPS, which the Company generally attributes to liquidity issues rather than credit issues, the Company recorded an unrealized loss of $0.1 million to accumulated other comprehensive income as of July 3, 2010. Due

to the Company s belief that the market for these collateralized instruments may take in excess of twelve months to fully recover, the Company has classified these investments as noncurrent and has included them in investments on the Unaudited Condensed Consolidated Balance Sheet at July 3, 2010. As of July 3, 2010, the Company continues to earn interest on all of its ARPS instruments. Any future fluctuation in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income. If the Company determined that any decrease in the value of the instruments was other-than-temporary, it would record a charge to earnings as appropriate. The Company is not certain how long it may be required to hold each security. However, given the Company s current cash position, liquid cash equivalents and expected cash provided by operations, it believes it has the ability to hold, and intends to continue to hold the ARPS as long-term investments until the market stabilizes.

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present the Company s assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at July 3, 2010 and January 2, 2010 (in thousands):

	Long-Term Investments
Balance as of January 2, 2010	$ 4,264
Redemption	(125)
Recovery of previous write-downs to other comprehensive income	26
Balance as of July 3, 2010	$ 4,165

	Long-Term Investments
Balance as of December 31, 2008	$ 6,351
Redemption	(2,150)
Recovery of previous write-downs to other comprehensive income	63
Balance as of January 2, 2010	$ 4,264

Note 3 Inventory

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

Note 4 Intangibles

Intangibles subject to amortization are expensed on a straight-line basis. Amortization expense relating to intangibles totaled $0.1 million and $0.2 million for the thirteen weeks ended July 3, 2010 and July 4, 2009, respectively. Additionally, amortization expense relating to intangibles totaled $0.2 million and $0.5 million for the twenty-six weeks ended July 3, 2010 and July 4, 2009, respectively. Assembled workforce, which is included in intangible assets, decreased by $0.01 million as of July 3, 2010 due to foreign currency fluctuations.

Intangibles, excluding goodwill, consisted of the following at July 3, 2010 and January 2, 2010 (in thousands):

		July 3, 2010			January 2, 2010		
	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	$ (391)	$ 1,644	$ 1,191	$ (190)	$ 1,001
Software	2 - 5 years	1,040	(1,040)		1,040	(1,040)	
Assembled workforce	7 years	453	(129)	324	455	(87)	368
Purchased domain names	3 years	175	(175)		175	(175)	

Sub-Total		3,703	(1,735)	1,968	2,861	(1,492)	1,369
Intangible assets not subject to amortization:							
Domain names	Indefinite life	1,902		1,902	1,745		1,745
Total		$ 5,605	$ (1,735)	$ 3,870	$ 4,606	$ (1,492)	$ 3,114

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5 Contingencies

On June 25, 2009, the Company filed a lawsuit in the United States District Court for the Central District of California (Court) against Parts Geek LLC, and 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 on August 12, 2009. On January 27, 2010, the complaint was amended to include claims for copyright infringement and to add an additional party, Lucas Thomason. Parts Geek filed an answer and counterclaims to the amended complaint on February 22, 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. On June 7, 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 on August 11, 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. The Company is not required to pay the fees and costs at this time as there is no final resolution to the matter; a bond will be posted to guarantee payment, at a minimal cost to the Company.

On November 4, 2009, a complaint was filed by Parts Geek LLC against the Company and Google in the United States District Court for the District of New Jersey for, among other things, trademark infringement and related unfair advertising practices, as well as web crawling. The Company has been served, and both defendants filed a motion to dismiss the claim or to move the action to the Northern District of California. On April 1, 2010, the motion to move the action to the Northern District of California was granted and the motion to dismiss the claim was denied without prejudice. On May 5, 2010 the plaintiffs voluntarily dismissed the lawsuit.

The Company has responded to an inquiry by the California Air Resources Board (CARB) into sales of non-California compliant catalytic converters in the state of California via our stock-ship and drop-ship network. On March 4, 2010, and again on June 16, 2010, the Company met with CARB to discuss alleged sales of catalytic converters into California by the Company and third-party suppliers that are not compliant with California regulations. CARB informed the Company that penalties shall be assessed with regard to any non-compliant sales; discussions are ongoing, and due to a number of variables, any penalties are not estimable at this time. This will impact sale of products for emissions systems to those states and may adversely impact our sales and operating results. The Company is unable to assess the amount of the final monetary cost in this regard, other than legal fees that have been and may continue to be incurred in preparing responses and defending the Company in the inquiry and that there will be an associated cost for penalties in this matter.

The Company is also subject to other legal proceedings and claims which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the potential loss, if any, of such matters cannot be reasonably estimated. However, the Company believes that, except for the matters described above, 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.

Note 6 Comprehensive Income

The Company reports comprehensive income (loss) in accordance with ASC 220, *Comprehensive Income*, which defines comprehensive income (loss) as net income (loss) affected by non-stockholder changes in equity. Comprehensive income (loss) for the thirteen and twenty-six weeks ended July 3, 2010 and the thirteen and twenty-six weeks ended July 4, 2009 is as follows (in thousands):

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
Net Income (loss)	$ 462	$ 629	$ 2,009	$ (50)
Foreign currency translation adjustments	(75)	61	13	60

Unrealized gain in investments	75		66	
Comprehensive income	$ 462	$ 690	$ 2,088	$ 10

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7 Reserve for Sales Returns and Allowances

Sales returns are recorded in the period in which the related sale is recognized. Credits are issued to customers for returned products which totaled $11.5 million for the twenty-six weeks ended July 3, 2010. The Company s sales returns and allowances reserve totaled $0.7 million and $1.0 million at July 3, 2010 and January 2, 2010, respectively.

Note 8 Income Taxes

For the thirteen weeks ended July 3, 2010 and July 4, 2009, the effective tax rate for the Company was 32.8% and 42.7%, respectively. Additionally, for the twenty-six weeks ended July 3, 2010 and July 4, 2009, the effective tax rate for the Company was 36.9% and 102.8%, respectively. The Company s effective tax rate differed from the U.S. federal statutory rate primarily as a result of state income taxes and other non-deductible permanent differences. The income tax provision for the thirteen weeks ended July 4, 2009 was higher, primarily due to additional foreign and state taxes resulting from less favorable rates and a lower percentage of foreign earnings in the quarter. The income tax provision for the twenty-six weeks ended July 4, 2009 was higher, primarily due to a $1.1 million tax effect of stock option forfeitures and other non-deductible permanent differences.

As of July 3, 2010, 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 recognize accrued interest and penalties related to unrecognized tax benefits as income tax expense.

The Company is subject to U.S. federal income tax as well as income tax of foreign and state tax jurisdictions. The Company s foreign and state income tax returns are open to audit under the statute of limitations for the tax years 2005 through 2009. The Company does not anticipate a significant change to the total amount of unrecognized tax benefits within the next twelve months.

Note 9 Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings per share is applicable only in periods of net income and is computed by dividing net income by the weighted average number of common shares outstanding for the period and potentially dilutive common stock equivalents outstanding for the period. Periods of net loss require the diluted computation to be the same as the basic computation. For the thirteen weeks ended July 3, 2010 and July 4, 2009, options to purchase 1,417,610 and 4,344,734 shares, respectively, of potentially anti-dilutive common stock equivalents were outstanding. For the twenty-six weeks ended July 3, 2010 and July 4, 2009, options to purchase 1,373,399 and 4,577,731 shares, respectively, of potentially anti-dilutive common stock equivalents were outstanding.

Net income (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 income (loss) per share:

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
	(in thousands, except share and per share data)			
Net Income (Loss) Per Share				
Numerator:				
Net income (loss)	$ 462	$ 629	$ 2,009	$ (50)
Denominator:				
Weighted-average common shares outstanding (basic)	30,314,478	29,846,757	30,158,797	29,846,757

Common equivalent shares				
Common equivalent shares from common stock options and warrants	1,679,969	548,432	1,564,519	
Weighted-average common shares outstanding (diluted)	31,994,447	30,395,189	31,723,316	29,846,757
Basic net income (loss) per share	$ 0.02	$ 0.02	$ 0.07	$ (0.00)
Diluted net income (loss) per share	$ 0.01	$ 0.02	$ 0.06	$ (0.00)

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10 Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC 718, *Stock Compensation*, which was adopted on January 1, 2006. No stock options were granted prior to January 1, 2006. 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 operations as general and administrative, marketing, fulfillment or technology expense, based on employee departmental classifications.

Under these guidelines, the fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. The Company currently uses the Black-Scholes option pricing model to estimate the fair value of share-based payment awards. The determination of the fair value of share-based payment awards utilizing the Black-Scholes is affected by the Company s stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. As of July 3, 2010, the Company did not have an adequate history of market prices of its common stock as the Company only recently became a public company, and as such, the Company estimates volatility using historical volatilities of similar public entities. The expected life of the awards is based on a simplified method which defines the life as the average of the contractual term of the options and the weighted average vesting period for all open tranches. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of awards. The dividend yield assumption is based on the Company s expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees and non-employee directors 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.

Under the 2007 Omnibus Incentive Plan, the Company granted stock options to purchase 120,000 shares of common stock during the thirteen weeks ended July 3, 2010 at a weighted-average grant date fair value of $8.32 per share. The Company granted stock options to purchase 290,000 shares of common stock during the twenty-six weeks ended July 3, 2010 at a weighted-average grant date fair value of $6.89 per share. The Company had $3.1 million of unrecognized share-based compensation expense related to stock options outstanding as of July 3, 2010, which expense is expected to be recognized over a weighted-average period of 2.31 years. During the thirteen weeks ended July 3, 2010, options to purchase 67,158 shares were exercised under this plan and the total intrinsic value of such exercised options was $0.2 million. During the twenty-six weeks ended July 3, 2010, options to purchase 229,746 shares were exercised and the total intrinsic value of the exercised options was $0.6 million. The intrinsic value is calculated as the difference between the exercise price of the underlying awards and the fair value price of the Company s common stock for options that were in-the-money as of July 3, 2010.

Under the 2007 New Employee Incentive Plan, there were no new options granted during the twenty-six weeks ended July 3, 2010. The Company had $0.5 million of unrecognized share-based compensation expense related to stock options outstanding as of July 3, 2010, which expense is expected to be recognized over a weighted-average period of 1.97 years. During the twenty-six weeks ended July 3, 2010, there were no options exercised under this plan.

Under the 2006 Equity Incentive Plan, there were no new options granted during the twenty-six weeks ended July 3, 2010. The Company had $0.1 million of unrecognized share-based compensation expense related to stock options outstanding as of July 3, 2010, which expense is expected to be recognized over a weighted-average period of 0.41 years. During the twenty-six weeks ended July 3, 2010, there were no options exercised under this plan.

On May 5, 2009, the Company issued warrants to purchase up to 30,000 shares of common stock, which warrants terminate seven years after their grant date. The warrants were issued in connection with the financial advisory services provided by a consultant to the Company. The warrants vest in thirty-six equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing May 5, 2009. On April 27, 2010, the Company issued additional warrants to purchase up to 20,000 shares of common stock to the same holder in connection with the financial advisory services provided to the Company. The grant date fair value of the additional warrants issued on April 27, 2010 was $2.12 per share. The Company determined the fair value of the warrants at the date of grant using the Black-Scholes option pricing

model based on the estimated fair value of the underlying common stock. The weighted-average grant date fair value of the outstanding warrants as of July 3, 2010 was $3.48 per share.

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U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 11 Deferred Compensation Plan

In January 2010, the Company adopted the U.S. Auto Parts Network, Inc. Management Deferred Compensation Plan (the Deferred Compensation Plan), for the purpose of providing highly compensated employees a program to meet their financial planning needs. The Deferred Compensation Plan provides participants with the opportunity to defer up to 90% of their base salary and up to 100% of their annual earned bonus, all of which, together with the associated investment returns, are 100% vested from the outset. The Deferred Compensation Plan, which is designed to be exempt from most provisions of the Employee Retirement Security Act of 1974, is 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 liability (consisting of employer contributions, employee deferrals and associated earnings) is general unsecured obligations of USAP. 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. As of July 3, 2010, the assets and associated liabilities of the Deferred Compensation Plan were $0.2 million and $0.2 million, respectively, and are included in other non-current assets and non-current liabilities, respectively, in our consolidated balance sheets. The associated liabilities mainly include the employee contributions of $0.1 million and the employer contributions of $0.02 million made as of July 3, 2010. Included in other expense, the Company recorded a loss of $0.03 million for the change in the cash surrender value of the Company-owned life insurance policies during the quarter ended July 3, 2010.

Note 12 Subsequent Events

As the Company disclosed on a Current Report on Form 8-K filed with the SEC on August 4, 2010, on August 2, 2010, Go Fido, Inc. (the Acquisition Sub), a wholly-owned subsidiary of USAP, entered into a Stock Purchase Agreement (the SPA) with Automotive Specialty Accessories and Parts, Inc. (WAG), 2000 Riverside Capital Appreciation Fund, L.P. (Riverside) on its own behalf as a stockholder of WAG and as the stockholder representative of all other stockholders of WAG, and the other stockholders of WAG. Upon the terms and subject to the conditions set forth in the SPA and upon closing of the transactions contemplated by the SPA, the Acquisition Sub purchased all of the outstanding capital stock of WAG, and WAG became a wholly-owned subsidiary of the Acquisition Sub (the Acquisition).

At closing of the Acquisition on August 12, 2010, the base purchase price paid by USAP was $27.5 million. The purchase price was paid in cash. Approximately $22.9 million of the purchase price will be used in part to repay certain indebtedness owed by WAG to various creditors, to pay WAG s selling expenses and bonuses payable to certain of WAG s employees and management in connection with the closing of the SPA. $1.8 million of the purchase price shall be used to fund a reserve to be used by Riverside in its capacity as stockholder representative primarily to fund adjustments under the working capital adjustment provision of the SPA; which working capital adjustment and a cash adjustment shall be made 30 days after closing. The remainder of the purchase price will be paid to the holders of WAG s preferred stock, except that all WAG common stock and options and warrants to purchase WAG stock were purchased (in the case of the common stock) or cancelled (in the case of the options and warrants) in connection with the closing of the Acquisition in exchange for consideration of $1 per holder. USAP guaranteed all of the Acquisition Sub s obligations under the SPA pursuant to a separate guarantee delivered to WAG in connection with the execution of the SPA (the Guarantee), which provides, among other things, that WAG can pursue USAP directly for any breach of the SPA by Acquisition Sub. In addition, the Acquisition Sub, in connection with the closing of the SPA, assumed approximately $11 million of certain of WAG s other existing obligations, largely consisting of trade payables.

On August 13, 2010, the Company entered into a credit facility (Credit Facility) with Silicon Valley Bank. The credit facility is comprised of a term loan in the amount of $25 million and a revolving line of credit in the amount of $10 million. The term loan shall be repaid in fully amortizing quarterly installments of principal and interest, with the final installment due on June 30, 2014. Interest on the revolver shall be paid no less than quarterly, with any outstanding principal due on June 30, 2014. The credit facility includes financial covenants such as Maximum Funded Debt to Consolidated EBITDA, Liquidity, and Consolidated Fixed Charge Coverage Ratio, as well as certain operating covenants that restrict extraordinary actions of the Company. The term loan was fully funded; there were no monies drawn on the revolving line of credit at the time the Credit Facility was consummated.

USAP will account for this acquisition in accordance with ASC 805, *Business Combinations*, which provides guidance on the accounting and reporting for transactions that represent business combinations to be accounted for under the acquisition method.

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

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC, including our Annual Report on Form 10-K for the year ended January 2, 2010 and subsequent reports on Forms 10-Q and 8-K, which discuss our business in greater detail. The section entitled Risk Factors set forth below, and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition in the future. You should carefully consider those risks, in addition to the other information in this report and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.

Overview

We are one of the largest online providers of aftermarket auto parts, including body parts, engine parts, performance parts and accessories. Our user-friendly websites provide customers with a broad selection of Stock Keeping Units, or 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* and *www.partstrain.com*. 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 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, acquiring the Partsbin business, improving our Internet marketing proficiency and commencing sales in online marketplaces. As a result, our business has grown since 2000, generating net sales of $176.3 million for the year ended January 2, 2010.

International Operations. In April 2007, we entered into a purchase agreement to bring in-house certain sales and customer service employees based in the Philippines who were providing support to us through our outsourced call center provider, Access Worldwide. As of the closing of this transaction, approximately 171 of the Access Worldwide employees had agreed to transition over to direct employment by our Philippines subsidiary. The purchase price for the right to acquire this assembled workforce was approximately $1.7 million. We had 858 employees in our Philippines operations as of July 3, 2010. In addition to our Philippines operations, we own a Canadian subsidiary to facilitate sales of our products in Canada which currently has no employees. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a cost-effective manner, and we expect to continue to add headcount and infrastructure to our offshore operations.

Acquisitions. From time to time, we may acquire certain businesses, websites, domain names or other assets. In May 2006, we completed the acquisition of All OEM Parts, Inc., The Partsbin.com, Inc., and their affiliated companies (Partsbin), which expanded our product offering and enhanced our ability to reach more customers. The Partsbin acquisition significantly increased our net sales and added a complementary, proprietary drop-ship order fulfillment method, and operations in Canada. In the third quarter of 2009, we completed the acquisition of the assets of a small website and the related domain names which further expanded and enhanced our product offering and our ability to reach more customers. In the first quarter of 2010, we completed two additional website and domain name asset acquisitions, which will increase our net sales and internet traffic. We may pursue additional acquisition opportunities in the future to increase our share of the aftermarket auto parts market or expand our product offerings. As we disclosed in Note 12- Subsequent Events Go Fido, Inc., a wholly-owned subsidiary of USAP, completed the purchase of all of the outstanding capital stock of Automotive Specialty Accessories and Parts, the owner of WAG and WAG is now a wholly-owned subsidiary of Go Fido, Inc.

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Executive Summary

We achieved a double digit sales growth in the quarter ended July 3, 2010, delivering record net sales of $53.2 million, an increase of 21.5% from $43.8 million in the quarter ended July 4, 2009. The Company s sales began accelerating in June 2009 with year over year internet sales for June 2010 rising 18% in addition to June 2009 s 19% growth. The Company completed the second quarter of fiscal 2010 with quarterly adjusted EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization and by adding current year s stock compensation expense to EBITDA for the year) of $3.3 million compared to $3.2 million for the second quarter of fiscal 2009 due to the strong sales growth in 2010. In evaluating financial condition and operating performance, the Company also focuses on the following key metrics:

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 table below reconciles net income (loss) to adjusted EBITDA for the periods presented (in thousands):

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
Net income (loss)	$ 462	$ 629	$ 2,009	$ (50)
Interest income, net	(34)	(49)	(55)	(140)
Income tax provision	225	469	1,175	1,832
Amortization of intangibles	124	153	245	520
Depreciation and amortization	1,950	1,134	3,934	2,153
EBITDA	2,727	2,336	7,308	4,315
Share-based compensation	612	820	1,472	1,847
Adjusted EBITDA	$ 3,339	$ 3,156	$ 8,780	$ 6,162

Change in Fiscal Year

The Company s fiscal year is based on a 52/53 week fiscal year ending on the first Saturday following December 31. The change in the Company s reporting year from a calendar year to a 52/53 week fiscal year was disclosed and effective as of January 1, 2009; therefore, there was no transition period in connection with this change in the Company s fiscal year end.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, intangible and other long-lived assets and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments

about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. There were no significant changes to our critical accounting policies during the quarter ended July 3, 2010, as compared to those policies disclosed in our annual report on Form 10-K for the fiscal year ended January 2, 2010, except for the change in accounting for revenue recognition due to the amendment of freight contract terms as described in Note 1- Summary of Significant Accounting Policies Revenue Recognition of our Notes to Unaudited Condensed Consolidated Financial Statements.

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Results of Operations

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

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	65.4	63.8	65.1	63.4
Gross profit	34.6	36.2	34.9	36.6
Operating expenses:				
Marketing	13.5	13.0	13.1	13.2
General and administrative	12.0	11.0	11.1	11.5
Fulfillment	5.5	6.4	5.6	6.5
Technology	2.2	3.1	2.1	2.7
Amortization of intangibles	0.2	0.3	0.2	0.6
Total operating expenses	33.4	33.8	32.1	34.5
Income from operations	1.2	2.4	2.8	2.1
Other income (expense):				
Other expense	0.0	(0.1)	0.0	0.0
Interest income, net	0.1	0.1	0.1	0.0
Total other income, net	0.1	0.0	0.1	0.0
Income before income taxes	1.3	2.4	2.9	2.1
Income tax provision	0.4	1.0	1.1	2.2
Net income (loss)	0.9%	1.4%	1.8%	(0.1)%

Estimated Impact of the Change in Fiscal Year to a 52/53 Week on the Twenty-Six Weeks Ended July 4, 2009.

Net sales were $1.2 million higher for the twenty-six weeks ended July 4, 2009, on a 52/53 week basis, primarily due to three additional business days during the first quarter of fiscal 2009 and one less business day in the second quarter of fiscal 2009. Excluding these additional days, net sales would have been $82.3 million in the twenty six weeks ended July 4, 2009 compared to $83.5 million as reported.

Net loss would remain $0.1 million or $0.00 per diluted share.

The 2009 change to a 52/53 week fiscal year will not have a material effect on future quarters.

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Thirteen and Twenty-Six Weeks Ended July 3, 2010 Compared to Thirteen and Twenty-Six Weeks Ended July 4, 2009

Net Sales and Gross Margin

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
Net sales	$ 53,188	$ 43,805	$ 109,479	$ 83,469
Cost of sales	34,791	27,937	71,275	52,961
Gross profit	$ 18,397	$ 15,868	$ 38,204	$ 30,508
Gross margin	34.6%	36.2%	34.9%	36.6%

Net sales increased $9.4 million or 21.4% and $26.0 million or 31.2% for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively. The year over year increase for the quarter was primarily due to a 20.4% increase in our online business, which consists of our e-commerce and online marketplace channels, as well as advertising sold on our e-commerce sites. Our e-commerce channel includes a network of e-commerce websites, supported by our call-center sales agents who generate cross-sell and up-sell opportunities. We also sell our products through our online marketplaces, which primarily consist of auction and other third-party websites. Our offline business, which consists of our Kool-Vue and wholesale operations, increased 36.0%. The year over year increase for the twenty-six week period was primarily due to a 30.6% increase in our online business and a 38.4% increase in our offline business. Excluding the additional two business days in 2009, the twenty-six week period would have been $82.3 resulting in a 33.0% year over year increase for the current twenty-six week period ended July 3, 2010.

E-commerce net sales increased $6.7 million or 19.0% to $42.0 million from $35.3 million for the thirteen weeks ended July 3, 2010 and July 4, 2009, respectively. E-commerce net sales increased $17.9 million or 27.1% to $84.1 million from $66.1 million for the twenty-six weeks ended July 3, 2010 and July 4, 2009, respectively. The total number of placed orders in our e-commerce channel increased to 440,000 and 863,000 orders for the thirteen and twenty-six weeks ended July 3, 2010, respectively, compared to 363,000 and 679,000 orders for the thirteen and twenty- six weeks ended July 4, 2009, respectively. The increase for both periods was primarily attributed to an increase in unique visitors to our websites, higher conversion rate and an increase in revenue capture rate, which is the amount of dollars retained by us after taking into consideration any credit card decline, returns, and product fulfillment. Excluding the two additional business days in 2009, e-commerce net sales for the twenty-six week period would have been $65.1 million resulting in a 29.2% year over year increase for the current twenty-six week period ended July 3, 2010.

Online marketplace net sales increased $1.8 million or 37.8% to $6.6 million for the thirteen weeks ended July 3, 2010 from $4.8 million for the thirteen weeks ended July 4, 2009. Sales increased $5.6 million or 57.1% to $15.4 million for the twenty-six week period ended July 3, 2010 from $9.8 million for the twenty-six weeks ended July 4, 2009. The increase for both periods was primarily due to higher traffic to our websites and more auctions listed.

Our offline business, which consists of sales from our Kool-Vue TM and wholesale operations, increased 36.0% or $1.1 million and 38.4% or $2.3 million for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively, due to an increase in our customer base.

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

Gross profit increased $2.5 million or 15.9% during the thirteen weeks ended July 3, 2010, as compared to the thirteen weeks ended July 4, 2009, primarily due to increased sales across all sales channels except for advertising sold on our e-commerce sites. Gross margin decreased by 160 basis points to 34.6% primarily due to higher freight charges associated with fuel surcharges and a discontinuation of certain high margin loyalty programs. Gross profit increased $7.7 million or 25.2% during the twenty-six weeks ended July 3, 2010, as compared to the twenty-six weeks ended July 4, 2009, due to increased sales across all sales channels. Gross margin decreased by 160 basis points to 34.9% primarily due to an unfavorable freight mix to common carriage freight versus parcel freight, combined with overall higher freight charges associated with fuel

surcharges.

During the thirteen and twenty-six weeks ended July 3, 2010, we recognized $0.6 million and $1.5 million, respectively, of share-based compensation expense, net of capitalized internally developed software. Based on options outstanding as of July 3, 2010, we expect to recognize approximately $3.7 million in additional share-based compensation expense over a weighted average period of 2.3 years.

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Marketing Expense

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
Marketing expense	$ 7,138	$ 5,680	$ 14,351	$ 11,015
Percent of net sales	13.5%	13.0%	13.1%	13.2%

Marketing expense increased $1.5 million or 25.7% and $3.3 million or 30.3% for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively. Marketing expense as a percentage of net sales increased by 0.5% for the thirteen weeks ended July 3, 2010 compared to the thirteen weeks ended July 4, 2009, primarily due to higher amortization costs related to software developments in the current periods. Marketing expense as a percentage of net sales decreased by 0.1% for the twenty-six weeks ended July 3, 2010, compared to the twenty-six weeks ended July 4, 2009, primarily due to more efficient advertising spend partially offset by amortization costs related to software developments.

General and Administrative Expense

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
General and administrative expense	$ 6,395	$ 4,811	$ 12,132	$ 9,576
Percent of net sales	12.0%	11.0%	11.1%	11.5%

General and administrative expenses increased $1.6 million or 32.9% for the thirteen weeks ended July 3, 2010, compared to the thirteen weeks ended July 4, 2009. General and administrative expense as a percentage of net sales increased by 1.0% for the thirteen weeks ended July 3, 2010, compared to the thirteen weeks ended July 4, 2009, primarily due to $1.2 million of legal fees incurred to protect our intellectual property. General and administrative expenses increased $2.6 million or 26.7% for the twenty-six weeks ended July 3, 2010, compared to the twenty-six weeks ended July 4, 2009. General and administrative expense as a percentage of net sales decreased by 0.4% for the twenty-six weeks ended July 3, 2010, compared to the twenty-six weeks ended July 4, 2009, primarily due to fixed cost leverage from higher sales partially offset by an increase in legal costs to protect our intellectual property.

Fulfillment Expense

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
Fulfillment expense	$ 2,924	$ 2,809	$ 6,167	$ 5,461
Percent of net sales	5.5%	6.4%	5.6%	6.5%

Fulfillment expense increased $0.1 million or 4.1% and $0.7 million or 12.9% for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively. Fulfillment expense as a percentage of net sales decreased by 0.9% for the twenty-six weeks ended July 3, 2010, compared to the twenty-six weeks ended July 4, 2009, respectively, primarily due to fixed cost leverage from higher sales.

Technology Expense

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
Technology expense	$ 1,158	$ 1,343	$ 2,176	$ 2,271
Percent of net sales	2.2%	3.1%	2.1%	2.7%

Technology expense decreased $0.2 million or 13.8% and $0.1 million or 4.2% for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively, Technology as a percentage of revenue decreased 0.9% and 0.6% for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively, primarily due to fixed cost leverage from higher sales.

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Amortization of Intangibles

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
Amortization of Intangibles	$ 124	$ 153	$ 245	$ 520
Percent of net sales	0.2%	0.3%	0.2%	0.6%

Amortization of intangibles decreased by $0.03 million or 19.2% and $0.3 million or 52.9% for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively. The decrease for both periods was primarily due to the full amortization of certain intangible assets. We estimate aggregate amortization expense for the remaining twenty six weeks ending January 1, 2011 (fiscal 2010) is expected to be $246,000 and for the fiscal years ending 2011, 2012, 2013, 2014, and 2015 to be approximately $492,000, $492,000, $457,000, $273,000, and $3,000, respectively.

Interest Income, Net

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
Interest income, net	$ 34	$ 49	$ 55	$ 140

Interest income, net decreased by $0.02 million or 31.4% and $0.1 million or 60.1% for the thirteen and twenty-six weeks ended July 3, 2010, compared to the thirteen and twenty-six weeks ended July 4, 2009, respectively. The decreases are primarily due to a drop in interest rates.

Income Tax Provision

	Thirteen Weeks Ended July 3, 2010	Thirteen Weeks Ended July 4, 2009	Twenty-Six Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 4, 2009
			(in thousands)	
Income tax provision	$ 225	$ 469	$ 1,175	$ 1,832

For the thirteen weeks ended July 3, 2010 and July 4, 2009, the effective tax rate for the Company was 32.8% and 42.7%, respectively. Additionally, for the twenty-six weeks ended July 3, 2010 and July 4, 2009, the effective tax rate for the Company was 36.9% and 102.8%, respectively. The income tax provision for the thirteen weeks ended July 4, 2009 was higher, primarily due to additional foreign and state taxes resulting from less favorable rates and a lower percentage of foreign earnings in the quarter. The income tax provision for the twenty-six weeks ended July 4, 2009 was higher, primarily due to a $1.1 million tax effect of stock option forfeitures and other non-deductible permanent differences.

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Liquidity and Capital Resources

We have historically funded our operations from cash generated from operations, credit facilities, bank and stockholder loans, an equity financing and capital lease financings. We cancelled our line of credit effective December 31, 2008 and have not established a new line of credit as of July 3, 2010.

We had cash and cash equivalents of $15.2 million as of July 3, 2010, representing a $11.0 million decrease from $26.2 million of liquid assets as of January 2, 2010. The decrease in our cash and cash equivalents as of July 3, 2010 was primarily due to investments in property and equipment, purchases of marketable securities, and cash paid for intangible assets, which was offset in part from cash generated from operations in the current period.

Net cash provided from operating activities increased by $1.7 million to $9.3 million from $7.6 million for the twenty-six weeks ended July 3, 2010 and July 4, 2009, respectively. The change in cash from operating activities was primarily due to the increase in our accounts payable, accrued expenses, and net income partially offset by an increase in inventory and accounts receivable driven largely by the 31% increase in net sales.

Net cash flows used in investing activities increased by $13.8 million to $21.3 million from $7.5 million for the twenty-six weeks ended July 3, 2010 and July 4, 2009, respectively. The change in cash from investing activities was primarily due to the increases in purchase of investments by $13.9 million and purchase of property and equipment by $2.4 million partially offset by the increase in sale of marketable securities of $3.8 million.

Cash provided by financing activities for the twenty-six weeks ended July 3, 2010 totaled $0.9 million, primarily due to proceeds of $0.7 million from the exercise of stock options.

We had working capital of $44.3 million as of July 3, 2010, which was primarily due to the cash generated from our initial public offering. The historical seasonality in our business during the fourth and first calendar quarters of each year cause cash and cash equivalents, inventory and accounts payable to be generally higher in these quarters, resulting in fluctuations in our working capital. We anticipate that funds generated from operations and cash on hand will be sufficient to meet our working capital needs and expected capital expenditures for at least the next twelve months. Our future capital requirements may, however, vary materially from those now planned or anticipated. Changes in our operating plans, lower than anticipated net sales, increased expenses, continued or worsened economic conditions, or other events, including those described in Risk Factors, may cause us to seek debt or equity financings in the future. Financings may not be available on acceptable terms, on a timely basis, or at all, and our failure to raise adequate capital when needed could negatively impact our growth plans and our financial condition and results of operations. In addition, our $4.2 million (fair value) of ARPS investments as of July 3, 2010 remain classified as long-term investments as a result of failed auctions and market liquidity issues. We may not have immediate access to those funds.

We have consolidated our offices in the Philippines into one office for operational efficiency in the first half of fiscal 2010, although we have an ongoing partial lease obligation through the third quarter of fiscal 2010. We spent $1.8 million in capital improvements to build out the new facility.

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

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 in subsequent periods.

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.

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ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Market Rate 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 United States interest rates and conditions in the credit markets. We also have some exposure related to foreign currency fluctuations. We do not have other derivative financial instruments. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We attempt to increase the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities.

Interest Rate Risk. Our investment securities generally consist of high-grade auction rate preferred securities. As of July 3, 2010, our long-term investments included $4.2 million (fair value) of investments in ARPS, which consist of high-grade (A or AAA rated) collateralized debt obligations issued by municipalities and state agencies. Our ARPS have an interest rate that is reset in short intervals through auctions. The recent conditions in the global credit markets have prevented some investors from liquidating their holdings of ARPS because the amount of securities submitted for sale has exceeded the amount of purchase orders for these securities. If there is insufficient demand for the securities at the time of an auction, the auction may not be completed and the interest rates may be reset to predetermined higher rates. When auctions for these securities fail, the investments may not be readily convertible to cash until a future auction of these investments is successful or they are redeemed or mature. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an impairment charge.

On February 13, 2008, we were informed that there was insufficient demand at auctions for four of our high-grade ARPS, representing approximately $7.8 million. As a result, these affected securities are currently not liquid and the interest rates have been reset to the predetermined higher rates. For the period February 13, 2008 through July 3, 2010, we have received partial redemptions at par on all four ARPS totaling $3.5 million. The remaining principal balance on our ARPS is $4.2 million as of July 3, 2010.

In the event we need to access the funds that are in an illiquid state, we will not be able to do so without the possible loss of principal until a future auction for these investments is successful or they are redeemed by the issuer. At this time, management has not obtained sufficient evidence to conclude that these investments are impaired or that they will not be settled in the short term, although the market for these investments is presently uncertain. If we are unable to sell these securities in the market or they are not redeemed, then we may be required to hold them indefinitely. We do not have a need to access these funds for operational purposes for the foreseeable future. We plan to continue to monitor and evaluate these investments on an ongoing basis for impairment. Based on our ability to access our cash and other short-term investments, our expected cash flows, and our other sources of cash, we do not anticipate that the potential illiquidity of these investments will affect our ability to execute our current business plan. However, due to the illiquidity in the market, we have recorded $0.1 million of unrealized losses on our investment portfolio as of July 3, 2010.

Foreign Currency Risk. Our purchases of auto parts from our Asian suppliers are denominated in U.S. Dollars; however, a change in the foreign currency exchange rates could impact our product costs over time. Our financial reporting currency is the U.S. Dollar and changes in exchange rates significantly affect our reported results and consolidated trends. For example, if the U.S. Dollar weakens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit, and operating expenses will be higher than if currencies had remained constant. Likewise, if the U.S. Dollar strengthens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit and operating expenses will be lower than if currencies had remained constant. Our operating expenses in the Philippines are generally paid in Philippine Pesos, and as the exchange rate fluctuates, it adversely or favorably impacts our operating results. In light of the above, we believe that a fluctuation of 10% in the Peso/U.S. Dollar exchange rate would have approximately a $0.6 million impact on our operating expenses for the twenty-six week period ended July 3, 2010. 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.

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ITEM 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by 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 CEO and CFO have concluded that, as of such date, our disclosure controls and procedures were effective to meet the objectives for which they were designed.

Changes in Internal Control Over Financial Reporting

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

Inherent Limitations on Internal Controls

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

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PART II. Other Information

ITEM 1. Legal Proceedings

The information set forth under Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report, is incorporated herein by reference.

ITEM 1A. Risk Factors

Our business is subject to a number of risks, some of which are discussed below. Other risks are presented elsewhere in this report and in the information incorporated by reference into this report. 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 risks actually occur, our business, financial condition or results of operations could be materially adversely affected, the value of our common stock could 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 of aftermarket auto parts sales. 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.

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

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

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

As part of our growth strategy, we acquired WAG on August 12, 2010 and we expect that we will selectively pursue additional acquisitions of businesses, technologies or services in order to expand our capabilities, enter new markets or increase our market share. Integrating any newly acquired businesses websites, technologies or services is likely to be expensive and time consuming. For example, our acquisition of 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. If we are unable to successfully complete the integration of acquisitions, we may not realize the anticipated synergies from such acquisition, and our business and results of operations could suffer. To finance any future acquisitions, it may also be necessary for us to raise additional capital through public or private financings or to obtain bank financing. Additional funds may not be available on terms that are favorable to us, and, in the case of equity financings, would result in dilution to our stockholders. Future acquisitions by us could also result in large and immediate write-offs, assumption of debt and unforeseen liabilities and significant adverse accounting charges, any of which could substantially harm our business, financial condition and results of operations.

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

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

- 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.

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

We acquire substantially all of our products from manufacturers and distributors located in Taiwan, China and the United States. Our top ten suppliers represented approximately 58% of our total product purchases during the twenty-six weeks ended July 3, 2010. 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 and distribute those products to our customers in a timely manner. For the twenty-six weeks ended July 3, 2010, our product purchases from a single supplier represented 20% of our total product purchases. If we do not maintain our existing relationships with this supplier and our other distributors on acceptable commercial terms, we will need to obtain other suppliers and may not be able to continue to offer a broad selection of merchandise at competitive prices, and our sales may decrease.

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

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 adversely affect our business and financial condition.

We rely on third parties for the shipment of our products and we cannot be sure that these relationships will continue on terms favorable to us, or at all. Shipping costs have increased from time to time, and may continue to increase, which could harm our business, prospects, financial

condition and results of operations by increasing our costs of doing business and resulting in reduced gross margins. In addition, if our relationships with these third parties are terminated or impaired, or if these third parties are unable to deliver products for us, whether due to labor shortage, slow down or stoppage, deteriorating financial or business condition, responses to terrorist attacks or for any other reason, we would be required to use alternative carriers for the shipment of products to our customers. Changing carriers could have a negative effect on our business and operating results due to reduced visibility of order status and package tracking and delays in order processing and product delivery, and we may be unable to engage alternative carriers on a timely basis, upon terms favorable to us, or at all.

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

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

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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 OEM and aftermarket auto parts to either the do-it-yourself or do-it-for-me customer segments. Current or potential competitors include the following:

- national auto parts retailers such as Advance Auto Parts, AutoZone, Napa Auto Parts, CarQuest, O Reilly Automotive and Pep Boys;
- large online marketplaces such as Amazon.com and eBay;
- other online retailers;
- local independent retailers or niche auto parts online retailers; and

wholesale aftermarket auto parts distributors such as LKQ Corporation.

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

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

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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 original equipment manufacturers (OEMs) to the validity of the aftermarket auto parts industry and claims of intellectual property infringement could adversely affect our business and the viability of the aftermarket auto parts industry.

Original equipment manufacturers have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEMs have brought such claims in federal court and with the United States International Trade Commission. We have received in the past, and we anticipate we may in the future receive, communications alleging that certain products we sell infringe the patents, copyrights, trademarks and trade names or other intellectual property rights of OEMs or other third parties. For instance, after 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 two legal actions that were initiated by Ford against us.

The United States Patent and Trademark Office records indicate that OEMs are seeking and obtaining more design patents 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 a material 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 two 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, and www.partstrain.com,* and have invested time and money in the purchase of domain names and other intellectual property, which may be impaired if we cannot protect such intellectual property. We may be unable to protect these domain names or acquire or maintain relevant domain names in the United States and in other countries. If we are not able to protect our trademarks, domain names or other intellectual property, we may experience difficulties in achieving and maintaining brand recognition and customer loyalty.

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

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

rights. In the event our product catalog is damaged or is stolen, copied or otherwise replicated to compete with us, whether lawfully or not, we may lose an important competitive advantage and our business could be harmed.

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

We utilize open-source software such as Linux, Apache, MySQL, PHP, Fedora and Perl throughout our web properties and supporting infrastructure. 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 recently been subjected to multiple typhoons and a volcanic eruption. In addition, California has in the past experienced power outages as a result of limited electrical power supplies and recent fires in the southern part of the state. Such outages, natural disasters and similar events may recur in the future and could disrupt the operation of our business. Our technology infrastructure is also vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. Although the critical portions of our systems are redundant and backup copies are maintained offsite, not all of our systems and data are fully redundant. We do not presently have a formal disaster recovery plan in effect and may not have sufficient insurance for losses that may occur from natural disasters or catastrophic events. Any substantial disruption of our technology infrastructure could cause interruptions or delays in our business and loss of data or render us unable to accept and fulfill customer orders or operate our websites in a timely manner, or at all.

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Risks Related To Our Common Stock

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

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

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

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

As of July 3, 2010, our executive officers and directors and entities that are affiliated with them beneficially owned in the aggregate approximately 45% 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 control 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;

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

the success of our brand-building and marketing campaigns;

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

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

technical difficulties, system downtime or Internet brownouts;

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

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

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

While management has concluded that our internal controls over financial reporting were effective as of January 2, 2010, we have in the past, and could in the future, have a material weakness or significant deficiency in our control over financial reporting or fail to comply with Section 404 of the Sarbanes-Oxley Act of 2002. If we fail to properly maintain an effective system of internal control over financial reporting, it could impact our ability to prevent fraud or to issue our financial statements in a timely manner that presents fairly our financial condition and results of operations. The existence of any such deficiencies or weaknesses, even if cured, may also lead to the loss of investor confidence in the reliability of our financial statements, could harm our business and negatively impact the trading price of our common stock. Such deficiencies or material weaknesses may also subject us to lawsuits, investigations and other penalties.

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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.

Vehicle miles driven have fluctuated and may decrease, resulting in a decline of our revenues and negatively affecting our results of operations.

We and our industry depend on the number of vehicle miles driven. 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.

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

Our investment securities consist of high-grade auction rate preferred securities (ARPS). As of July 3, 2010, our long-term marketable securities were comprised of $4.2 million (par value) of high-grade (AAA rated) ARPS issued primarily by closed end funds that primarily hold debt obligations from municipalities. The recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings, including their holdings of ARPS. In response to the credit situation, in February 2008, we instructed our investment advisor to liquidate all our investments in close end funds and move these funds into money market investments but there was insufficient demand at auction for our remaining four high-grade ARPS, representing approximately $7.8 million at that time. As a result, these affected securities currently are not liquid, and have been reclassified as long-term investments. For the period February 13, 2008 through July 3, 2010, an additional $3.5 million of our investments in ARPS were redeemed but we do not know when we will have access to the capital in these remaining investments. In the event we need to access the funds that are in an illiquid state, we will not be able to do so without a loss of principal or until a future auction on these investments is successful, the securities are redeemed by the issuer or a secondary market emerges. If we cannot readily access these funds, we may be required to borrow funds or issue additional debt or equity securities to meet our capital requirements. As of July 3, 2010, management concluded that these remaining investments were impaired and has recorded an impairment charge to other comprehensive income totaling $0.1 million. Management is not sure that these investments will not be settled in the short term, although the market for these investments is presently uncertain. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an additional impairment charge.

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

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

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.

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

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

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

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

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

We are subject to federal and state consumer protection laws and regulations, including laws protecting the privacy of customer non-public information and regulations prohibiting unfair and deceptive trade practices, as well as laws and regulations governing businesses in general and the Internet and e-commerce and certain environmental laws. Additional laws and regulations may be adopted with respect to the Internet, the effect of which on e-commerce is uncertain. These laws may cover issues such as user privacy, spyware and the tracking of consumer activities, marketing e-mails and communications, other advertising and promotional practices, money transfers, pricing, content and quality of products and services, taxation, electronic contracts and other communications, intellectual property rights, and information security. Furthermore, it is not clear how existing laws such as those governing issues such as property ownership, sales and other taxes, trespass, data mining and collection, and personal privacy apply to the Internet and e-commerce. For example, California has enacted legislation banning the sale of catalytic converters that do not meet California emissions regulations, and the current federal administration has indicated that 13 additional states will be allowed to enact their own legislation that mirrors the California legislation. On March 4, 2010 and on June 16, 2010, we met with the California Air Resources Board (CARB) to discuss alleged sales of catalytic converters into California by us and our third-party suppliers that are not compliant with California regulations. CARB informed us that penalties may be assessed with regard to any non-compliant sales; discussions are ongoing, and any penalties are not estimable at this time. This will impact sale of products for emissions systems to those states and may adversely impact our sales and operating results. To the extent we expand into international markets, we will be faced with complying with local laws and regulations, some of which may be materially different than U.S. laws and regulations. Any such foreign law or regulation, any new U.S. law or regulation, or the interpretation or application of existing laws and regulations to the Internet or other online services, 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.

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.

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ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds
None.

ITEM 3. Defaults Upon Senior Securities.
None.

ITEM 4. Removed and Reserved

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ITEM 5. Other Information

The Company has been advised that Houman Akhavan entered into a written sales plan intended to comply with the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934 (the Plan) to sell certain shares of the Company s common stock held by Mr. Akhavan. The Plan was established during an open window consistent with the Company s insider trading policy, and under Mr. Akhavan s belief that he was not in possession of material non-public information.

Shares may be sold under the Plan at any time that the Company s stock attains certain pre-arranged minimum prices as set forth in the Plan, which prices are at a significant premium to the current trading price for our common stock. Sales may take place beginning as early as the next open trading window and will terminate upon the earlier of the sale of all the shares in the Plan or December 31, 2011, or as otherwise provided under the Plan. Mr. Akhavan will have no control over the timing of any sales under the Plan, and there is no guarantee that the shares covered by the Plan will actually be sold. The Plan covers up to 24,000 shares, which represents a portion of Mr. Akhavan s holdings in the Company s common stock.

Actual sales made pursuant to the Plan will be disclosed publicly through Form 4 and Form 144 filings with the SEC.

ITEM 6. Exhibits

The following exhibits are filed herewith.

Exhibit No.	Description
10.57	Stock Purchase Agreement executed August 2, 2010 among the Acquisition Sub, WAG, Riverside and the other stockholders of WAG (incorporated by reference to Exhibit 10.57 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on August 4, 2010)
10.59	Loan and Security Agreement, dated August 13, 2010, between Bank, USAPN, ASAP, Go Fido Inc., Parts Bin, Lobo, Whitney, Value, Private Label, Pacific, AutoMD, and Local Body Shops
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

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SIGNATURES

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

Dated: August 17, 2010

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

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

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

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