

U.S. Auto Parts Network, Inc.
Form 10-Q
August 06, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 29, 2013

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.

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

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

16941 Keegan Avenue, Carson, CA 90746
(Address of Principal Executive Office) (Zip Code)

(310) 735-0085
(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 1, 2013, the registrant had 33,218,657 shares of common stock outstanding, \$0.001 par value.

Table of Contents

**U.S. AUTO PARTS NETWORK, INC.
 QUARTERLY REPORT ON FORM 10-Q
 FOR THE THIRTEEN WEEKS ENDED JUNE 29, 2013**

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION		Page
ITEM 1.	<u>Financial Statements</u>	4
	<u>Consolidated Balance Sheets (Unaudited) at June 29, 2013 and December 29, 2012</u>	4
	<u>Consolidated Statements of Comprehensive Operations (Unaudited) for the Thirteen and Twenty-Six Weeks Ended June 29, 2013 and June 30, 2012</u>	5
	<u>Consolidated Statements of Cash Flows (Unaudited) for the Twenty-Six Weeks Ended June 29, 2013 and June 30, 2012</u>	6
	<u>Notes to Consolidated Financial Statements (Unaudited)</u>	7
ITEM 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
ITEM 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
ITEM 4.	<u>Controls and Procedures</u>	41

PART II. OTHER INFORMATION

ITEM 1.	<u>Legal Proceedings</u>	42
ITEM 1A.	<u>Risk Factors</u>	42
ITEM 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	55
ITEM 3.	<u>Defaults Upon Senior Securities</u>	56
ITEM 4.	<u>Mine Safety Disclosures</u>	56
ITEM 5.	<u>Other Information</u>	56
ITEM 6.	<u>Exhibits</u>	57

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, PartsTraffic, Partsbin, Kool-Vue, Auto-Vend, JC Whitney and Stylintrucks, amongst others, are our United States trademarks. All other trademarks and trade names appearing in this report are the property of their respective owners.

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS***(Unaudited, In Thousands, Except Par and Per Share Liquidation Value)*

	June 29, 2013	December 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 851	\$ 1,030
Short-term investments	118	110
Accounts receivable, net of allowances of \$215 and \$221 at June 29, 2013 and December 29, 2012, respectively	5,344	7,431
Inventory	34,181	42,727
Deferred income taxes	51	39
Other current assets	4,481	4,176
Total current assets	45,026	55,513
Property and equipment, net	21,009	28,559
Intangible assets, net	1,769	3,227
Other non-current assets	1,492	1,578
Total assets	\$ 69,296	\$ 88,877
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 19,611	\$ 28,025
Accrued expenses	7,450	10,485
Revolving loan payable	3,269	16,222
Current portion of capital leases payable	148	70
Other current liabilities	3,967	4,738
Total current liabilities	34,445	59,540
Capital leases payable, net of current portion	9,437	70
Deferred income taxes	416	314
Other non-current liabilities	2,152	1,309
Total liabilities	46,450	61,233
Commitments and contingencies		
Stockholders equity:		
Series A convertible preferred stock, \$0.001 par value; \$1.45 per share liquidation value or aggregate of \$6,017; 4,150 shares authorized; 4,150 and 0 shares issued and outstanding at June 29, 2013 and December 29, 2012, respectively	4	
Common stock, \$0.001 par value; 100,000 shares authorized; 33,209 and 31,128 shares issued and outstanding at June 29, 2013 and December 29, 2012, respectively	33	31
Additional paid-in-capital	167,924	159,781

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

Accumulated other comprehensive income	411	384
Accumulated deficit	(145,526)	(132,552)
Total stockholders' equity	22,846	27,644
Total liabilities and stockholders' equity	\$ 69,296	\$ 88,877

See accompanying notes to consolidated financial statements.

Table of Contents

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS

(Unaudited, in Thousands, Except Per Share Data)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Net sales	\$ 67,889	\$ 80,719	\$ 133,294	\$ 168,155
Cost of sales ⁽¹⁾	48,876	56,378	94,543	117,186
Gross profit	19,013	24,341	38,751	50,969
Operating expenses:				
Marketing	11,186	12,978	22,377	26,428
General and administrative	4,678	4,714	9,365	10,584
Fulfillment	4,991	5,639	10,372	11,557
Technology	1,316	1,700	2,831	3,236
Amortization of intangible assets	107	341	213	681
Impairment loss on property and equipment	4,832		4,832	
Impairment loss on intangible assets	1,245		1,245	
Total operating expenses	28,355	25,372	51,235	52,486
Loss from operations	(9,342)	(1,031)	(12,484)	(1,517)
Other income (expense):				
Other income, net	72	4	79	35
Interest expense	(228)	(181)	(415)	(390)
Loss on debt extinguishment		(360)		(360)
Total other expense, net	(156)	(537)	(336)	(715)
Loss before income taxes	(9,498)	(1,568)	(12,820)	(2,232)
Income tax provision	69	128	90	252
Net loss	(9,567)	(1,696)	(12,910)	(2,484)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	31	(3)	25	24
Unrealized gains on investments	2	4	2	29
Total other comprehensive income	33	1	27	53
Comprehensive loss	\$ (9,534)	\$ (1,695)	\$ (12,883)	\$ (2,431)
Basic and diluted net loss per share	\$ (0.29)	\$ (0.06)	\$ (0.40)	\$ (0.08)
Shares used in computation of basic and diluted net loss per share	33,119	30,651	32,130	30,644

(1)

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

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

See accompanying notes to consolidated financial statements.

Table of Contents**U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***(Unaudited, In Thousands)*

	Twenty-Six Weeks Ended	
	June 29, 2013	June 30, 2012
Operating activities		
Net loss	\$ (12,910)	\$ (2,484)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	7,264	7,748
Amortization of intangible assets	213	681
Impairment loss on property and equipment	4,832	
Impairment loss on intangible assets	1,245	
Deferred income taxes	90	253
Share-based compensation expense	750	958
Stock awards issued for non-employee director service	21	32
Amortization of deferred financing costs	41	51
Loss on debt extinguishment		360
Loss from disposition of assets		4
Changes in operating assets and liabilities:		
Accounts receivable	2,087	(1,566)
Inventory	8,546	3,018
Other current assets	(323)	(587)
Other non-current assets	144	
Accounts payable and accrued expenses	(10,783)	(7,997)
Other current liabilities	(771)	(2,430)
Other non-current liabilities	490	294
Net cash provided by (used in) operating activities	936	(1,665)
Investing activities		
Additions to property and equipment	(4,815)	(5,374)
Proceeds from sale of property and equipment		14
Cash paid for intangible assets		(16)
Proceeds from sale of marketable securities and investments		3,171
Purchases of marketable securities and investments		(7)
Purchases of company-owned life insurance	(106)	(166)
Net cash used in investing activities	(4,921)	(2,378)
Financing activities		
Borrowings from revolving loan payable	10,187	16,561
Payments made on revolving loan payable	(23,140)	(3,653)
Proceeds from sale leaseback transaction	9,584	
Payments made on long-term debt		(17,875)
Payment of debt extinguishment costs		(175)
Proceeds from issuance of Series A convertible preferred stock	6,017	
Payment of issuance costs from Series A convertible preferred stock	(822)	
Proceeds from issuance of common stock	2,235	
Payment of issuance costs from common stock	(223)	
Payments of debt financing costs		(345)
Payments on capital leases	(62)	(68)
Proceeds from exercise of stock options	22	43
Other		611
Net cash provided by (used in) financing activities	3,798	(4,901)

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

Effect of exchange rate changes on cash	8	14
Net change in cash and cash equivalents	(179)	(8,930)
Cash and cash equivalents, beginning of period	1,030	10,335
Cash and cash equivalents, end of period	\$ 851	\$ 1,405
Supplemental disclosure of non-cash investing and financing activities:		
Accrued asset purchases	\$ 1,046	\$ 1,616
Property acquired under capital lease		104
Unrealized gain on investments	2	29
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	\$	\$
Cash paid during the period for interest	367	293

See accompanying notes to consolidated financial statements.

Table of Contents

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, In Thousands, Except Per Share Data)

Note 1 Summary of Significant Accounting Policies and Nature of Operations

U.S. Auto Parts Network, Inc. (including its subsidiaries) is a distributor of aftermarket auto parts and accessories and was established in 1995. The Company entered the e-commerce sector by launching its first website in 2000 and currently derives the majority of its revenues from online sales channels. The Company sells its products to individual consumers through a network of websites and online marketplaces. Through AutoMD.com, the Company educates consumers on maintenance and service of their vehicles. The site provides auto information, with tools for diagnosing car troubles, locating repair shops and do-it-yourself (DIY) repair guides. Our flagship websites are located at www.autopartswarehouse.com, www.jcwhitney.com, www.AutoMD.com and our corporate website is located at www.usautoparts.net. References to the Company, we, us, or our refer to U.S. Auto Parts Network, Inc. and its consolidated subsidiaries.

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

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

Basis of Presentation

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to U.S. Securities and Exchange Commission (SEC) Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of June 29, 2013 and the consolidated results of operations for the thirteen and twenty-six weeks ended June 29, 2013 and June 30, 2012, and cash flows for the twenty-six weeks ended June 29, 2013 and June 30, 2012. 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 June 29, 2013 are not necessarily indicative of those to be expected for the entire fiscal year. The accompanying consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 29, 2012, which was filed with the SEC on March 25, 2013.

During the thirteen and twenty six weeks ended June 29, 2013, the Company's revenues declined by 15.9% and 20.7%, respectively, compared to the same periods in 2012. Additionally, the Company incurred a net loss of \$9,567 and \$12,910 for the thirteen and twenty six weeks ended June 29, 2013, after incurring net losses of \$35,978 and \$15,137 in fiscal years 2012 and 2011, respectively. Based on our current operating plan, we believe that our existing cash, cash equivalents, investments, cash flows from operations and available debt financing will be sufficient to finance our operational cash needs through at least the next twelve months. However, we expect the downward trend in our revenues and net loss to continue in the second half of 2013. Should the downward trend worsen or continue in 2014, it could severely impact our liquidity as we may not be able to provide positive cash flows from operations in order to meet our working capital requirements. We may need to borrow additional funds from our credit facility, which under certain circumstances may not be available, sell our assets or seek equity or additional debt financing in the future. There can be no assurance that we would be able to raise such additional financing or engage in such asset sales on acceptable terms, or at all. If our expected downward trend in revenues, and net loss continues for longer than we expect because our strategies to return to positive sales growth and profitability are not successful or otherwise, and if we are not able to raise adequate additional financing or proceeds from additional asset sales to continue to fund our ongoing operations, we will need to defer, reduce or eliminate significant planned expenditures, restructure or significantly curtail our operations.

Table of Contents

Fiscal Periods

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

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, but are not limited to, those related to revenue recognition, uncollectible receivables, valuation of inventory, valuation of deferred tax assets and liabilities, valuation of intangible assets and other long-lived assets, recoverability of software development costs, contingencies and share-based compensation expense that results from estimated grant date fair values and vesting of issued equity awards. Actual results could differ from these estimates.

Statement of Cash Flows

The net change in the Company's book overdraft is presented net of accounts payable in the operating activity of the consolidated statement of cash flows. The book overdraft represents a credit balance in the Company's general ledger but the Company has a positive bank account balance.

Cash and Cash Equivalents

The Company considers all money market funds and short-term investments purchased with original maturities of ninety days or less to be cash equivalents.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value at June 29, 2013 and December 29, 2012 due to their short-term maturities. Marketable securities and investments are carried at fair value, as discussed below. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of our revolving loan payable, classified as current liability in our consolidated balance sheet, approximates its carrying amount because the interest rate is variable. If the Company's revolving loan payable (see *Note 6 Borrowings*) had been measured at fair value at June 29, 2013, it would be categorized in Level 2 of the fair value hierarchy, as the estimated value would be based on the quoted market prices for the same or similar issues or on the current rates available to the Company for debt of the same or similar terms. Accordingly, financial instruments that are not measured at fair value include accounts receivable, accounts payable and debt. Refer to *Note 3 Fair Value Measurements* for additional fair value information.

Accounts Receivable and Concentration of Credit Risk

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

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

Marketable Securities and Investments

Marketable securities and investments were comprised of closed-end funds primarily invested in mutual funds. Mutual funds are classified as short-term investments available-for-sale and recorded at fair market value, based on quoted prices of identical assets that are trading in active

markets as of the end of the period for which the values are determined.

Table of Contents***Other-Than-Temporary Impairment***

All of the Company's marketable securities and investments are subject to a periodic impairment review. The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. The Company considers various factors in determining whether to recognize an impairment charge, including the length of time and extent to which the fair value has been less than the Company's cost basis, the financial condition and near-term prospects of the investee, and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market value. No other-than-temporary impairment charges were recorded on any investments during the twenty-six week periods ended June 29, 2013 and June 30, 2012.

Inventory

Inventories consist of finished goods available-for-sale and are stated at the lower of cost or market value, determined using the first-in first-out (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 products are generally available from more than one supplier and seeks to maintain multiple sources for its products, both internationally and domestically. The Company primarily purchases products in bulk quantities to take advantage of quantity discounts and to ensure inventory availability. Inventory is reported at the lower of cost or market, adjusted for slow moving, obsolete or scrap product. Inventory at June 29, 2013 and December 29, 2012 was \$34,181 and \$42,727, respectively, which included items in-transit to our warehouses, in the amount of \$5,301 and \$6,418, respectively.

Website and Software Development Costs

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

Long-Lived Assets and Intangibles Subject to Amortization

The Company accounts for the impairment and disposition of long-lived assets, including intangibles subject to amortization, in accordance with ASC 360 *Property, Plant and Equipment* (ASC 360). Management assesses potential impairments whenever events or changes in circumstances indicate that the carrying value of an asset or asset group may not be recoverable. An impairment loss will result when the carrying value exceeds the undiscounted cash flows estimated to result from the use and eventual disposition of the asset or asset group. Impairment losses will be recognized in operating results to the extent that the carrying value exceeds the discounted future cash flows estimated to result from the use and eventual disposition of the asset or asset group. The Company continually uses judgment when applying these impairment rules to determine the timing of the impairment tests, undiscounted cash flows used to assess impairments, and the fair value of a potentially impaired asset or asset group. The reasonableness of our judgments could significantly affect the carrying value of our long-lived assets. During the second quarter of 2013, the Company recognized an impairment loss on property and equipment and intangible assets subject to amortization of \$4,832 and \$1,245, respectively. No such charges were recorded during the twenty-six weeks ended June 30, 2012. During the fourth quarter of 2012, the Company recognized an impairment loss on property and equipment and intangible assets subject to amortization of \$1,960 and \$1,745, respectively. If cash flows deteriorate, or if cash flows do not improve and additions to property and equipment continue at their current levels, it may result to future impairments. Refer to *Note 3 Fair Value Measurements*, *Note 4 Property and Equipment, Net* and *Note 5 Intangible Assets* for further details.

Revenue Recognition

The Company recognizes revenue from product sales and shipping revenues, net of promotional discounts and return allowances, when the following revenue recognition criteria are met: persuasive evidence of an arrangement exists, both title and risk of loss or damage have transferred, delivery has occurred, the selling price is fixed or determinable, and collectability is reasonably assured. The Company retains the risk of loss or damage during transit, therefore, revenue from product sales is recognized at the delivery date to customer, not upon shipment. Return allowances, which reduce product revenue by the Company's best estimate of expected product returns, are estimated using historical experience.

Table of Contents

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

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

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

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

Sales discounts are recorded in the period in which the related sale is recognized. Sales return allowances are estimated based on historical amounts and are recorded upon recognizing the related sales. Credits are issued to customers for returned products.

Cost of Sales

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

Warranty Costs

The Company or the vendors supplying its products provide the Company's customers limited warranties on certain products that range from 30 days to lifetime. In most cases, the Company's vendors are the party primarily responsible for warranty claims. Standard product warranties sold separately by the Company are recorded as deferred revenue and recognized ratably over the life of the warranty, ranging from one to five years. The Company also offers extended warranties that are imbedded in the price of selected private label products we sell. The product brands that include the extended warranty coverage are offered at three different service levels: (a) a five year unlimited product replacement, (b) a five year one-time product replacement, and (c) a three year one-time product replacement. Warranty costs relating to merchandise sold under warranty not covered by vendors are estimated and recorded as warranty obligations at the time of sale based on each product's historical return rate and historical warranty cost. The standard and extended warranty obligations are recorded as warranty liabilities and included in other current liabilities in the consolidated balance sheets. For the twenty-six weeks ended June 29, 2013 and June 30, 2012, the activity in our aggregate warranty liabilities was as follows:

	June 29, 2013	June 30, 2012
Warranty liabilities, beginning of period	\$ 282	\$ 384
Adjustments to preexisting warranty liabilities	(79)	(232)
Additions to warranty liabilities	89	157
Reductions to warranty liabilities	(29)	(73)
Warranty liabilities, end of period	\$ 263	\$ 236

Marketing Expense

Marketing costs, including advertising, are expensed as incurred. The majority of advertising expense is paid to internet search engine service providers and internet commerce facilitators. For the thirteen weeks ended June 29, 2013 and June 30, 2012, the Company recognized advertising costs of \$4,571 and \$5,241, respectively. For the twenty-six weeks ended June 29, 2013 and June 30, 2012, the Company recognized advertising costs of \$8,908 and \$11,321, respectively. Marketing costs also include depreciation and amortization expense and share-based compensation expense.

Table of Contents

General and Administrative Expense

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

Fulfillment Expense

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

Technology Expense

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

Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC 718 *Compensation - Stock Compensation* (ASC 718). All stock options issued to employees are recognized as share-based compensation expense in the financial statements based on their respective grant date fair values, and are recognized within the statement of comprehensive income or loss as marketing, general and administrative, fulfillment or technology expense, based on employee departmental classifications. Under this standard, the fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. The Company currently uses the Black-Scholes option pricing model to estimate the fair value of share-based payment awards, with the exception of options granted containing market conditions (none in fiscal year 2013 and 2012), for which the Company estimates the fair value using a Monte Carlo model. The determination of the fair value of share-based payment awards utilizing the Black-Scholes and Monte Carlo model is affected by the Company's stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends.

The Company incorporated its own historical volatility into the grant-date fair value calculations. The expected term of an award is based on combining historical exercise data with expected weighted time outstanding. Expected weighted time outstanding is calculated by assuming the settlement of outstanding awards is at the midpoint between the remaining weighted average vesting date and the expiration date. The risk-free interest rate assumption is based on observed interest rates appropriate for the expected life of awards. The dividend yield assumption is based on the Company's expectation of paying no dividends on its common stock. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures significantly differ from those estimates. The Company considers many factors when estimating expected forfeitures, including employee class, economic environment, and historical experience.

The Company accounts for equity instruments issued in exchange for the receipt of services from non-employee directors in accordance with the provisions of ASC 718. The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with ASC 505-50 *Equity-Based Payments to Non-Employees*. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services. Equity instruments awarded to non-employees are periodically re-measured as the underlying awards vest unless the instruments are fully vested, immediately exercisable and non-forfeitable on the date of grant.

Other Income, net

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

Interest Expense

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

Table of Contents

Income Taxes

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

The Company utilizes a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company considers many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. As of June 29, 2013, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. The Company's policy is to record interest and penalties as income tax expense.

Taxes Collected from Customers and Remitted to Governmental Authorities

We present taxes collected from customers and remitted to governmental authorities in accordance with the guidance on ASC 605-45-50-3 *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement, (That Is, Gross versus Net Presentation)*, on a net basis.

Leases

The Company analyzes lease agreements for operating versus capital lease treatment in accordance with ASC 840 *Leases*. Rent expense for leases designated as operating leases is expensed on a straight-line basis over the term of the lease. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as a capital lease asset and a capital lease payable in the consolidated balance sheets. Amounts due within one year are classified as current liabilities and the remaining balance as non-current liabilities.

Foreign Currency Translation

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

Comprehensive Income

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

Segment Data

The Company operates in two reportable segments and reporting revenues by product line or geographic location is impracticable. Certain long-lived assets are held in the Philippines (refer to *Note 4 Property and Equipment, Net*). The criteria the Company used to identify its reporting segments are primarily the nature of the products the Company sells and the consolidated operating results that are regularly reviewed by the Company's chief operating decision maker to assess performance and make operating decisions. We identified two reporting units, Base USAP, which is the core auto parts business, and AutoMD, an online automotive repair source, in accordance with ASC 280 Segment Reporting. There have been no significant revenues generated from AutoMD. AutoMD incurred total expenses of \$631 and \$571 during the thirteen weeks ended June 29, 2013 and June 30, 2012, respectively. AutoMD incurred total expenses of \$1,217 and \$1,108 during the twenty-six weeks ended

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

June 29, 2013 and June 30, 2012, respectively, which are primarily related to depreciation and amortization expense of capitalized website and software development costs. Total assets for AutoMD were \$2,502 and \$2,059 as of June 29, 2013 and December 29, 2012, respectively, which are primarily related to capitalized website and software development costs.

Table of Contents**Recent Accounting Pronouncements**

In February 2013, the Financial Accounting Standards Board (FASB) issued ASU 2013-02 to improve the reporting reclassifications out of accumulated other comprehensive income of various components. The guidance requires presentation of significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification either parenthetically on the face of the financial statements or in the notes. The Company adopted the provisions of ASU 2013-02 beginning fiscal year 2013. The adoption of the amendments did not have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The amendments in this ASU require an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. An entity is required to apply the amendments effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company will evaluate the impact of the amendments to the Company's consolidated financial statements.

Note 2 Investments

As of June 29, 2013 the Company held the following securities and investments, recorded at fair value:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Mutual funds ⁽¹⁾	\$ 118	\$	\$	\$ 118

As of December 29, 2012, the Company held the following securities and investments, recorded at fair value:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Mutual funds ⁽¹⁾	\$ 110	\$	\$	\$ 110

⁽¹⁾ Mutual funds are classified as short-term investments available-for-sale and recorded at fair market value, based on quoted prices of identical assets that are trading in active markets as of the end of the period for which the values are determined.

Proceeds from the sale of available-for-sale securities are disclosed separately in the accompanying consolidated statements of cash flow. For the twenty-six weeks ended June 29, 2013, there was no sale of available-for-sale securities. For the twenty-six weeks ended June 30, 2012, the Company recognized a realized loss of \$4 from the sale of mutual funds.

Note 3 Fair Value Measurements

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

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

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

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

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

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

We measure our financial assets and liabilities at fair value on a recurring basis using the following valuation techniques:

(a) **Market Approach** uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

(b) **Income Approach** uses valuation techniques to convert future estimated cash flows to a single present amount based on current market expectations about those future amounts, using present value techniques.

Table of Contents**Financial Assets Valued on a Recurring Basis**

As of June 29, 2013 and December 29, 2012, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company's financial instruments, including cash and cash equivalents and investments. The following table represents our fair value hierarchy and the valuation techniques used for financial assets measured at fair value on a recurring basis:

	As of June 29, 2013				Valuation Techniques
	Total	Level 1	Level 2	Level 3	
Assets:					
Cash and cash equivalents ⁽¹⁾	\$ 851	\$ 851	\$	\$	(a)
Investments - mutual funds ⁽²⁾	118	118			(a)
	\$ 969	\$ 969	\$	\$	

	As of December 29, 2012				Valuation Techniques
	Total	Level 1	Level 2	Level 3	
Assets:					
Cash and cash equivalents ⁽¹⁾	\$ 1,030	\$ 1,030	\$	\$	(a)
Investments - mutual funds ⁽²⁾	110	110			(a)
	\$ 1,140	\$ 1,140	\$	\$	

(1) Cash equivalents consist primarily of money market funds and short-term investments with original maturity dates of three months or less at the date of purchase, for which the Company determines fair value through quoted market prices.

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

During the twenty-six weeks ended June 29, 2013 and June 30, 2012, there were no transfers into or out of Level 1 and Level 2 assets.

Non-Financial Assets Valued on a Non-Recurring Basis

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

During the second quarter of 2013, the Company identified adverse events related to the Company's overall financial performance, including the continued downward trend in the Company's revenues and gross margin, and a sustained decline in the Company's share price, that would more likely than not reduce the fair value of the Company's long-lived assets below its carrying amount. The Company performed its impairment testing of long-lived assets, including intangible assets subject to amortization, in accordance with ASC 360 Property, Plant and Equipment.

The Company measures its non-financial assets at fair value on a non-recurring basis considering the following valuation techniques based on the Company's evaluation of the circumstances:

(a) **Market Approach** provides an estimation of fair value based on market prices in actual transactions and on asking prices for assets. Considerations such as time and condition of sale and terms of agreements are analyzed for comparable assets and are adjusted to arrive at an estimation of the fair value.

(b) **Income Approach** uses valuation techniques to convert future estimated cash flows to a single present amount based on current market expectations about those future amounts, using present value techniques.

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

(c) Cost Approach uses the concept of replacement cost as an indicator of fair value. The premise of the costs approach is that, if it were possible to replace the asset, a market participant would pay no more for an asset than the amount for which the asset could be replaced.

Table of Contents

The following table represents the fair value measurements for assets measured on a non-recurring basis as of the Company's impairment testing date, June 29, 2013 (in thousands):

	Fair Value	Impairment Charge	Valuation Techniques	Fair Value Hierarchy
Assets:				
Internally developed software	5,975	4,832	(b)	Level 3
Property and equipment		4,832		
Product design intellectual property	1,037	838	(b)	Level 3
Domain name	515	348	(b)	Level 3
Trade names WAG	217	59	(b)	Level 3
Intangible assets		1,245		
Total impairment loss		\$ 6,077		

For the period ended June 29, 2013, total impairment loss was \$6,077. The Company recorded impairment losses on property and equipment and intangible assets of \$4,832 and \$1,245, respectively. The fair value measurements are categorized as Level 3 of the fair value hierarchy, as the Company developed its own assumptions and analysis to determine if such assets were impaired. Refer to *Note 1 Summary of Significant Accounting Policies and Nature of Operations*, *Note 4 Property and Equipment, Net* and *Note 5 Intangible Assets* for additional details.

Note 4 Property and Equipment, Net

The Company's fixed assets are stated at cost less accumulated depreciation, amortization and impairment. Depreciation and amortization expense are provided for in amounts sufficient to relate the cost of depreciable and amortizable assets to operations over their estimated service lives. Depreciation and amortization expense for the thirteen weeks ended June 29, 2013 and June 30, 2012 was \$3,626 and \$4,001, respectively, including amortization expense of \$79 for the thirteen weeks ended June 29, 2013 for capital leased assets related to the LaSalle, Illinois facility (see sale-leaseback discussion below for details). Depreciation and amortization expense for the twenty-six weeks ended June 29, 2013 and June 30, 2012 was \$7,264 and \$7,748, respectively, including amortization expense of \$79 for the twenty-six weeks ended June 29, 2013 for capital leased assets related to the LaSalle, Illinois facility. The cost and related accumulated depreciation of assets retired or otherwise disposed of are removed from the accounts and the resultant gain or loss is reflected in earnings.

The Company accounts for the impairment of property and equipment in accordance with ASC 360. During the second quarter of 2013, the Company identified adverse events related to the Company's overall financial performance, including accelerating downward trend in the Company's revenues and gross margin, which indicate that the carrying amount of certain property and equipment may not be recoverable. Given the indicators of impairment, the Company utilized the Royalty Savings method in determining the fair values. Based on its analysis, the Company recognized an impairment loss on internally developed software of \$4,832. Any future decline in the fair value of an asset group could result in future impairments. The Company did not recognize any impairment loss on property and equipment for the twenty-six weeks ended June 30, 2012. Refer to *Note 1- Summary of Significant Accounting Policies and Nature of Operations* and *Note 3 Fair Value Measurements* for additional details.

Property and equipment consisted of the following at June 29, 2013 and December 29, 2012:

	June 29, 2013	December 29, 2012
Land	\$ 630	\$ 630
Building	8,877	10,680
Machinery and equipment	13,208	13,249
Computer software (purchased and developed) and equipment	51,471	46,884

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

Vehicles	264	261
Leasehold improvements	2,022	2,364
Furniture and fixtures	1,107	1,131
Construction in process	2,495	3,043
	80,074	78,242
Less accumulated depreciation, amortization and impairment	(59,065)	(49,683)
Property and equipment, net	\$ 21,009	\$ 28,559

Table of Contents

On April 17, 2013, the Company's wholly-owned subsidiary, Whitney Automotive Group, Inc. (WAG) closed the sale of its facility in LaSalle, Illinois for \$9,750 pursuant to a purchase and sale agreement dated April 17, 2013 between WAG and STORE Capital Acquisitions, LLC. The Company used the net proceeds of \$9,507 from this sale to reduce its revolving loan payable. Under the terms of the purchase and sale agreement, simultaneously with the execution of the purchase and sale agreement and the closing of the sale of the property, the Company entered into a lease agreement with STORE Master Funding III, LLC (STORE) whereby we leased back the property for our continued use as an office, retail and warehouse facility for storage, sale and distribution of automotive parts, accessories and related items for 20 years commencing upon the execution of the lease and terminating on April 30, 2033. The related assets represent the amounts included in land and building in the summary above. The Company's initial base annual rent is \$853 for the first year (Base Rent Amount), after which the rental amount will increase annually on May 1 by the lesser of 1.5% or 1.25 times the change in the Consumer Price Index as published by the U.S. Department of Labor's Bureau of Labor Statistics, except that in no event will the adjusted annual rental amount fall below the Base Rent Amount. We were not required to pay any security deposit. Under the terms of the lease, we are required to pay all taxes associated with the lease, pay for any required maintenance on the property, maintain certain levels of insurance and indemnify STORE for losses incurred that are related to our use or occupancy of the property. The lease was accounted for as a capital lease and the \$376 excess of the net proceeds over the net carrying amount of the property is amortized in interest expense on a straight-line basis over the lease term of 20 years. As of June 29, 2013, the carrying value of the capital leased asset included in property and equipment, net was \$9,428.

Construction in process primarily relates to the Company's internally developed software (refer to caption *Website and Software Development Costs* in *Note 1 Summary of Significant Accounting Policies and Nature of Operations*). Certain of the Company's net property and equipment were located in the Philippines as of June 29, 2013 and December 29, 2012, in the amount of \$739 and \$1,042, respectively.

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

	Years
Machinery and equipment	2 - 5
Computer software (purchased and developed)	2 - 3
Computer equipment	2 - 5
Vehicles	3 - 5
Leasehold improvements*	3 - 5
Furniture and fixtures	3 - 7
Land and building subject to capital lease	20

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

Note 5 Intangible Assets

Intangible assets consisted of the following at June 29, 2013 and December 29, 2012:

	Useful Life	June 29, 2013			December 29, 2012		
		Gross Carrying Amount	Accumulated Amort. and Impairment	Net Carrying Amount	Gross Carrying Amount	Accum. Amort. and Impairment	Net Carrying Amount
Intangible assets subject to amortization:							
Websites	5 years	\$	\$	\$	\$ 2,035	\$ (2,035)	\$
Internet platform intellectual property	10 months				4,300	(4,300)	
Product design intellectual property ⁽¹⁾	4 years	2,750	(1,713)	1,037	2,750	(722)	2,028
Customer relationships	4 years				2,050	(2,050)	
Assembled workforce	7 years				512	(512)	
Favorable lease	2.5 years				78	(78)	
Domain and trade names ⁽²⁾	10 years	1,199	(467)	732	5,067	(3,868)	1,199
Total		\$ 3,949	\$ (2,180)	\$ 1,769	\$ 16,792	\$ (13,565)	\$ 3,227

- (1) During the second quarter of 2013, based on the impairment analysis, the Company changed its estimated useful life for product design and intellectual property from 9 years to 4 years.
- (2) Prior to the fourth quarter of 2012, domain and trade names had an indefinite useful life. During the fourth quarter of 2012, after an impairment charge was recognized, the gross carrying amount was based on the fair value of the domain and trade names and the Company determined an estimated useful life of 10 years.

Table of Contents

During the second quarter of 2013, the Company recognized impairment losses on product design intellectual property and certain domain and trade names for \$838 and \$407, respectively. The impairment charges were primarily the result of lower sales and gross margin. Given the indicators of impairment, the Company utilized the Royalty Savings method in determining the fair values. The decrease in future cash flows resulted in these assets being impaired, as their carrying values exceeded the fair value. The Company did not recognize impairment loss on product design intellectual property and domain and trade names for the twenty-six weeks ended June 30, 2012. Refer to *Note 1- Summary of Significant Accounting Policies and Nature of Operations* and *Note 3 Fair Value Measurements* for additional details.

Intangible assets subject to amortization are expensed on a straight-line basis. Amortization expense relating to intangibles assets for the thirteen weeks ended June 29, 2013 and June 30, 2012 was \$107 and \$341, respectively. Amortization expense relating to intangibles assets for the twenty-six weeks ended June 29, 2013 and June 30, 2012 was \$213 and \$681, respectively.

The following table summarizes the future estimated annual amortization expense for these assets over the next five years:

2013	\$ 168
2014	336
2015	336
2016	336
2017	207
Thereafter	386
Total	\$ 1,769

Note 6 Borrowings

On April 26, 2012, the Company, certain of its wholly-owned domestic subsidiaries and JPMorgan Chase Bank, N.A., as sole lender and administrative agent entered into a Credit Agreement (the *Credit Agreement*). The Credit Agreement provides for a revolving commitment in an aggregate principal amount of up to \$40,000 (the *Credit Facility*), which is subject to a borrowing base derived from certain receivables, inventory and property and equipment. The Credit Facility matures on April 26, 2017. The Company used the proceeds of the loans borrowed on the closing date to repay in full its previous credit facility with Silicon Valley Bank. At June 29, 2013, our outstanding revolving loan balance was \$3,269. The customary events of default under the Credit Facility (discussed below) include certain subjective acceleration clauses, which management has determined the likelihood of such acceleration is more than remote, considering the recurring losses experienced by the Company, therefore a current classification of our revolving loan payable was required. Upon the satisfaction of certain conditions, the Borrowers have the right to increase the revolving commitments up to and above \$60,000. Borrowers may make a maximum of three such requests in a minimum amount of \$5,000 each. Upon approval of such an increase, the aggregate revolving commitment amount will be revised and the Credit Agreement amended as appropriate. The Company, to date, has not requested such increases.

On August 2, 2013, the Company, certain of its wholly-owned domestic subsidiaries and JPMorgan entered into a third amendment to the Credit Agreement (*Third Amended Credit Agreement*) amending the Credit Agreement to, among other things, reduce the revolving commitment in an aggregate principal amount of up to \$20,000 and upon satisfaction of certain conditions, the Borrowers have the right to increase the revolving commitments up to and above \$40,000.

Table of Contents

Loans drawn under the Credit Facility bear interest, at the Company's option, at a per annum rate equal to either (a) LIBOR plus an applicable margin of 1.50%, or (b) an alternate base rate minus an applicable margin of 0.50%. Each applicable margin as set forth in the prior sentence is subject to increase or decrease by 0.25% per annum based upon the Company's fixed charge coverage ratio. At June 29, 2013, the Company's LIBOR based interest rate was 2.0% (on \$2,000 principal) and the Company's prime based rate was 3.0% (on \$1,269 principal). A commitment fee, based upon undrawn availability under the Credit Facility bearing interest at a rate of 0.20% per annum, is payable monthly. Under the terms of the Credit Agreement, cash receipts are deposited into a lock-box, which are at the Company's discretion unless the cash dominion period is in effect, during which cash receipts will be used to reduce amounts owing under the Credit Agreement. The cash dominion period is triggered in an event of default or if excess availability is less than \$6,000 at any time, as defined, and will continue until, during the preceding 60 consecutive days, no event of default existed and excess availability has been greater than \$7,000 at all times. The Company's excess availability was \$11,446 at June 29, 2013. On March 12, 2013, we entered into a first amendment to the Credit Agreement (First Amended Credit Agreement). The First Amended Credit Agreement includes an amendment to the definition of covenant testing trigger period to commence on any day that excess availability is less than \$4,000 solely during the period March 1, 2013 through and including April 15, 2013 and continuing until excess availability has been greater than or equal to \$4,000 solely during the period of March 1, 2013 through and including April 15, 2013 at all times for 45 consecutive calendar days. As of the date hereof, the cash dominion period has not been in effect; accordingly no principal payments are currently due.

Certain of the Company's wholly-owned domestic subsidiaries are co-borrowers (together with the Company, the Borrowers) under the Credit Agreement, and certain other wholly-owned domestic subsidiaries are guarantors (the Guarantors and, together with the Borrowers, the Loan Parties) under the Credit Agreement. The Borrowers and the Guarantors are jointly and severally liable for the Borrowers' obligations under the Credit Agreement. The Loan Parties' obligations under the Credit Agreement are secured, subject to customary permitted liens and certain exclusions, by a perfected security interest in (a) all tangible and intangible assets and (b) all of the capital stock owned by the Loan Parties (limited, in the case of foreign subsidiaries, to 65% of the capital stock of such foreign subsidiaries). The Borrowers may voluntarily prepay the loans at any time without payment of a premium. The Borrowers are required to make mandatory prepayments of the loans (without payment of a premium) with net cash proceeds received upon the occurrence of certain prepayment events, which include certain sales or other dispositions of collateral, certain casualty or condemnation events, certain equity issuances or capital contributions, and the incurrence of certain debt.

The Credit Agreement contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries, including, among other things, restrictions on indebtedness, liens, fundamental changes, investments, dispositions, prepayment of other indebtedness, mergers, and dividends and other distributions. Concurrent with the Company's issuance of Series A Convertible Preferred Stock (Series A Preferred), the Company, certain of its wholly-owned domestic subsidiaries and JPMorgan entered into a second amendment to the Credit Agreement (Second Amended Credit Agreement) amending the Credit Agreement to, among other things, allow the Company to pay cash dividends on the Series A Preferred in an aggregate amount of up to \$400 per year and pay cash in lieu of issuing fractional shares upon conversion of or in payment of dividends on the Series A Preferred, each subject to certain restrictions set forth in the Second Amended Credit Agreement but without having to satisfy certain other conditions that would have otherwise applied to the payment of such dividends.

Under the Credit Agreement, the Company is not required to maintain a minimum fixed charge coverage ratio, unless excess availability is less than \$6,000, as defined, whereby a ratio of 1.0 to 1.0 will be required. Events of default under the Credit Agreement include: failure to timely make payments due under the Credit Agreement; material misrepresentations or misstatements under the Credit Agreement and other related agreements; failure to comply with covenants under the Credit Agreement and other related agreements; certain defaults in respect of other material indebtedness; insolvency or other related events; certain defaulted judgments; certain ERISA-related events; certain security interests or liens under the loan documents cease to be, or are challenged by the Company or any of its subsidiaries as not being, in full force and effect; any loan document or any material provision of the same ceases to be in full force and effect; and certain criminal indictments or convictions of any Loan Party. As of June 29, 2013, the Company was in compliance with all covenants under the Credit Agreement.

As of June 29, 2013, the Company had total capital leases payable of \$9,585. The present value of the net minimum payments on capital leases as of June 29, 2013 is as follows:

	June 29, 2013
Total minimum lease payments	\$ 19,687
Less amount representing interest	(10,102)
Present value of net minimum lease payments	9,585
Current portion of capital leases payable	(148)

Capital leases payable, net of current portion	\$ 9,437
--	----------

Table of Contents

Note 7 Stockholders Equity and Share-Based Compensation

Common Stock

The Company has 100,000 shares of common stock authorized. We have never paid cash dividends on our common stock. The following issuances of common stock were made during the twenty-six weeks ended June 29, 2013:

The Company issued 17 shares of common stock from option exercises under its various share-based compensation plans, as discussed below.

14 shares of common stock were awarded and issued to one non-employee member of the Board of Directors for service fees earned in the aggregate amount of \$21.

In March 2013, the Company entered into a Common Stock Purchase Agreement with William Blair & Company, LLC pursuant to which U.S. Auto Parts agreed to sell up to 2,050 shares of its common stock at a purchase price per share of \$1.09 for aggregate proceeds to the Company of approximately \$2,235. The transaction closed on April 3, 2013 and the Company incurred issuance costs of approximately \$223. The Company used the net proceeds to reduce its revolving loan payable.

Series A Convertible Preferred Stock

On March 25, 2013, the Company authorized the issuance of 4,150 shares of Series A Preferred and entered into a Securities Purchase Agreement pursuant to which the Company agreed to sell up to an aggregate of 4,150 shares of our Series A Preferred, \$0.001 par value per share at a purchase price per share of \$1.45 for aggregate proceeds to the Company of approximately \$6,017. On March 25, 2013, we sold 4,000 shares of Series A Preferred for aggregate proceeds of \$5,800. On April 5, 2013, we sold the remaining 150 shares of Series A Preferred for aggregate proceeds of \$217. The Company incurred issuance costs of approximately \$822 and used the net proceeds from the sale of the Series A Preferred to reduce its revolving loan payable.

Each share of Series A Preferred is convertible into shares of our common stock at the initial conversion price of \$1.45 per share or one share of common stock for each share of Series A Preferred. The conversion price will be adjusted for certain non-price based events, such as dividends and distributions on the common stock, stock splits, combinations, recapitalizations, reclassifications, mergers, or consolidations. If not previously converted by the holder, the Series A Preferred will automatically convert to common stock if the volume weighted average price for the common stock for any 30 consecutive trading days is equal to or exceeds \$4.35 per share. The shares that would be issued if the contingently convertible Series A Preferred were converted are excluded from the calculation of diluted earnings per share due to the Company's net loss position for the thirteen and twenty-six weeks ended June 29, 2013 (refer to *Note 8 Net Loss Per Share* for anti-dilutive securities).

In the event of any liquidation event, which includes changes of control of the Company and sales or other dispositions by the Company of more than 50% of its assets, the Series A Preferred is entitled to receive, prior and in preference to any distribution to the common stock, an amount per share equal to \$1.45 per share of Series A Preferred, plus all then accrued but unpaid dividends on such Series A Preferred. Following this distribution, if assets or surplus funds remain, the holders of the common stock shall share ratably in all remaining assets of the Company, based on the number of shares of common stock then outstanding. Notwithstanding the foregoing, if, in connection with any liquidation event, a holder of Series A Preferred would receive an amount greater than \$1.45 per share of Series A Preferred by converting such shares held by such holder into shares of common stock, then such holder shall be treated as though such holder had converted such shares of Series A Preferred into shares of common stock immediately prior to such liquidation event, whether or not such holder had elected to so convert.

Dividends on the Series A Preferred are payable quarterly at a rate of \$0.058 per share per annum in cash, in shares of common stock or in any combination of cash and common stock as determined by the Company's Board of Directors. Certain conditions are required to be satisfied in order for the Company to pay dividends on the Series A Preferred in shares of common stock, including (i) the common stock being registered pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934, as amended, (ii) the common stock being issued having been approved for listing on a trading market

Table of Contents

and (iii) the common stock being issued either being covered by an effective registration statement or being freely tradable without restriction under Rule 144 (subject to certain exceptions). The Series A Preferred shall each be entitled to one vote per share for each share of common stock issuable upon conversion thereof (excluding from any such calculation any dividends accrued on such shares) and shall vote together with the holders of common stock as a single class on any matter on which the holders of common stock are entitled to vote. In addition, the Company must obtain the consent of holders of at least a majority of the then outstanding Series A Preferred in connection with (a) any amendment, alteration or repeal of any provision of the certificate of incorporation or bylaws of the Company as to adversely affect the preferences, rights or voting power of the Series A Preferred, or (b) the creation, authorization or issuance of any additional Series A Preferred or any other class or series of capital stock of the Company ranking senior to or on parity with the Series A Preferred or any security convertible into, or exchangeable or exercisable for Series A Preferred or any other class or series of capital stock of the Company ranking senior to or on parity with the Series A Preferred. Concurrent with the Company's issuance of Series A Preferred, the Company, certain of its wholly-owned domestic subsidiaries and JPMorgan entered into a Second Amended Credit Agreement to allow the Company to pay cash dividends on the Series A Preferred in an aggregate amount of up to \$400 per year and pay cash in lieu of issuing fractional shares upon conversion of or in payment of dividends on the Series A Preferred (refer to *Note 6 Borrowings* of our Notes to Consolidated Financial Statements for additional details). At June 29, 2013, we accrued a dividend on the Series A Preferred of \$64. Such amount in cash dividends was paid on July 1, 2013.

Share-Based Compensation Plan Information

The Company adopted the 2007 Omnibus Incentive Plan (the 2007 Omnibus Plan) in January 2007, which became effective on February 8, 2007, the effective date of the registration statement filed in connection with the Company's initial public offering. Under the 2007 Omnibus Plan, the Company was previously authorized to issue 2,400 shares of common stock, under various instruments to eligible employees and non-employees of the Company, plus an automatic annual increase on the first day of each of the Company's fiscal years beginning on January 1, 2008 and ending on January 1, 2017 equal to (i) the lesser of (A) 1,500 shares of common stock or (B) five percent (5%) of the number of shares of common stock outstanding on the last day of the immediately preceding fiscal year or (ii) such lesser number of shares of common stock as determined by the Company's Board of Directors. Options granted under the 2007 Omnibus Plan generally expire no later than ten years from the date of grant and generally vest over a period of four years. The exercise price of all option grants must be equal to 100% of the fair market value on the date of grant. The 2007 Omnibus Plan also provides for automatic grant of options to purchase common stock and common stock awards to non-employee directors. As of June 29, 2013, 2,094 shares were available for future grants under the 2007 Omnibus Plan.

The Company adopted the 2007 New Employee Incentive Plan (the 2007 New Employee Plan) in October 2007. Under the 2007 New Employee Plan, the Company is authorized to issue 2,000 shares of common stock under various instruments solely to new employees. Options granted under the 2007 New Employee Plan generally expire no later than ten years from the date of grant and generally vest over a period of four years. The exercise price of all option grants must not be less than 100% of the fair market value on the date of grant. As of June 29, 2013, 782 shares were available for future grants under the 2007 New Employee Plan.

The Company adopted the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan (the 2006 Plan) in March 2006. All stock options to purchase common stock granted to employees in 2006 were granted under the 2006 Plan and had exercise prices equal to the fair value of the underlying stock, as determined by the Company's Board of Directors on the applicable option grant date. After fiscal year 2008, no shares have been available for future grants under the 2006 Plan.

The following table summarizes the Company's stock option activity for the twenty-six weeks ended June 29, 2013, and details regarding the options outstanding and exercisable at June 29, 2013:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value ⁽¹⁾
Options outstanding, December 29, 2012	7,428	\$ 5.13	6.23	
Granted	30	\$ 1.28		
Exercised	(17)	\$ 1.31		
Expired	(77)	\$ 4.71		
Forfeited	(174)	\$ 3.31		
Options outstanding, June 29, 2013	7,190	\$ 5.17	5.63	\$
Vested and expected to vest at June 29, 2013	6,986	\$ 5.20	5.54	\$

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

Options exercisable, June 29, 2013	6,099	\$	5.19	5.14	\$
------------------------------------	-------	----	------	------	----

- (1) These amounts represent the difference between the exercise price and the closing price of U.S. Auto Parts Network, Inc. stock on June 29, 2013 as reported on the NASDAQ National Market, for all options outstanding that have an exercise price currently below the closing price.

Table of Contents

The weighted-average fair value of options granted during the twenty-six weeks ended June 29, 2013 and June 30, 2012 was \$0.80 and \$2.65, respectively. The intrinsic value of stock options at the date of the exercise is the difference between the fair value of the stock at the date of exercise and the exercise price. During the twenty-six weeks ended June 29, 2013 and June 30, 2012, the total intrinsic value of the exercised options was \$4 and \$52, respectively. The Company had \$1,399 of unrecognized share-based compensation expense related to stock options outstanding as of June 29, 2013, which expense is expected to be recognized over a weighted-average period of 2.29 years.

Warrants

On May 5, 2009, the Company issued warrants to purchase up to 30 shares of common stock at an exercise price of \$2.14 per share, which warrants terminate seven years after their grant date. The warrants were issued in connection with the financial advisory services provided by a consultant to the Company. The warrants vested in thirty-six equal monthly increments of 0.83 shares each on the last calendar day of each calendar month commencing May 5, 2009. The grant date fair value of these warrants issued on May 5, 2009 was \$1.09 per share. Accordingly, these non-employee equity instruments were re-measured as they vested over the requisite service period. These warrants became fully vested during the second quarter of 2012, in which the final re-measured fair value was \$3.14 per share.

On April 27, 2010, the Company issued additional warrants to purchase up to 20 shares of common stock at an exercise price of \$8.32 per share, to the same consultant in connection with the financial advisory services provided to the Company. The warrants terminate seven years after their grant date. The warrants vested in twenty-four equal monthly increments of 0.83 shares each on the last calendar day of each calendar month commencing April 27, 2010. The grant date fair value of the additional warrants issued on April 27, 2010 was \$2.12 per share. Accordingly, these non-employee equity instruments were re-measured as they vested over the requisite service period. These warrants became fully vested during the quarter ended March 31, 2012, in which the final re-measured fair value was \$1.42 per share.

The Company determined the fair value of the warrants at the date of grant, and upon the re-measurement dates, using the Black-Scholes option pricing model based on the fair value of the underlying common stock, the exercise price, remaining contractual term, risk-free rate and expected volatility. No warrants were exercised during the fiscal year 2013. As of June 29, 2013, warrants to purchase 50 shares of common stock were outstanding and exercisable. The aggregate intrinsic value of outstanding and exercisable warrants was \$0 as of June 29, 2013, which was calculated as the difference between the exercise price of underlying awards and the closing price of the Company's common stock for warrants that were in-the-money. Total warrants share-based compensation expense recognized during the twenty-six weeks ended June 29, 2013 and June 30, 2012 was \$0 and \$16, respectively. The Company had no unrecognized share-based compensation expense related to warrants outstanding as of June 29, 2013.

Share-Based Compensation Expense

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Expected life	5.73 years	5.73 years	5.73 years	5.73 years
Risk-free interest rate	1.7%	1.0%	1.0%	1.0%
Expected volatility	73%	74%	72%	73%
Expected dividend yield	0%	0%	0%	0%

Table of Contents

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Marketing expense	\$ 69	\$ 152	\$ 153	\$ 196
General and administrative expense	220	155	502	577
Fulfillment expense	25	43	56	136
Technology expense	27	24	39	49
Total share-based compensation expense	\$ 341	\$ 374	\$ 750	\$ 958

The share-based compensation expense is net of amounts capitalized to internally-developed software of \$68 and \$85 during the thirteen weeks ended June 29, 2013 and June 30, 2012, respectively, and \$149 and \$136 during the twenty-six weeks ended June 29, 2013 and June 30, 2012, respectively.

Under ASC 718, forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures significantly differ from those estimates. The Company's estimated forfeiture rates are calculated based on actual historical forfeitures experienced under our equity plans. The Company's forfeiture rates were 16% to 34% for the twenty-six weeks ended June 29, 2013 and June 30, 2012.

Note 8 Net Loss Per Share

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Net loss per share:				
Numerator:				
Net loss	\$ (9,567)	\$ (1,696)	\$ (12,910)	\$ (2,484)
Dividends on Series A Convertible Preferred Stock	64		64	
Net loss available to common shares	\$ (9,631)	\$ (1,696)	\$ (12,974)	\$ (2,484)
Denominator:				
Weighted-average common shares outstanding (basic)	33,119	30,651	32,130	30,644
Common equivalent shares from common stock options and warrants				
Weighted-average common shares outstanding (diluted)	33,119	30,651	32,130	30,644
Basic and diluted net loss per share	\$ (0.29)	\$ (0.06)	\$ (0.40)	\$ (0.08)

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

	Thirteen Weeks Ended	Twenty-Six Weeks Ended
--	----------------------	------------------------

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

	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Common stock warrants	50	50	50	50
Series A Convertible Preferred Stock	4,140		1,076	
Options to purchase common stock	7,217	7,809	7,309	7,752
Total	11,407	7,859	8,435	7,802

Table of Contents**Note 9 Income Taxes**

As discussed in *Note 1 Summary of Significant Accounting Policies and Nature of Operations*, the Company applies the current U.S. GAAP on accounting for uncertain tax positions, which prescribe a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that has greater than 50 percent likelihood of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. As of June 29, 2013, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. The Company's policy is to record interest and penalties as income tax expense. The Company does not anticipate a significant change to the amount of unrecognized tax benefits within the next twelve months.

The Company is subject to U.S. federal income tax as well as income tax of foreign and state tax jurisdictions. The tax years 2008 - 2012 remain open to examination by the major taxing jurisdictions to which the Company is subject, except the Internal Revenue Service for which the tax year 2009 - 2012 remain open.

For the thirteen and twenty-six weeks ended June 29, 2013, the effective tax rate for the Company was (0.7)% for each period. The Company's effective tax rate for the thirteen and twenty-six weeks ended June 29, 2013 differed from the U.S. federal statutory rate primarily as a result of the recording of valuation allowance against the pre-tax losses. For the thirteen and twenty-six weeks ended June 30, 2012, the effective tax rate for the Company was (8.2)% and (11.3)%, respectively. The Company's effective tax rate for the thirteen and twenty-six weeks ended June 30, 2012 differed from the U.S. federal statutory rate primarily as a result of the recording of valuation allowance against the pre-tax losses and the increase in deferred tax liabilities related to tax deductible indefinite-lived intangible assets.

Note 10 Commitments and Contingencies**Facilities Leases**

The Company's corporate headquarters and warehouse facilities are located in Carson, California. As of June 29, 2013, we maintained multiple separate leases for the Carson, California facilities. The Company's corporate headquarters has an initial lease term of five years through October 2016, and optional renewals through January 2020. The Company also leases warehouse space in Chesapeake, Virginia under an agreement scheduled to expire in June 2016. The Company also leases office and warehouse space in Independence, Ohio which expired on June 30, 2013. The Company's Philippines subsidiary leases office space under a sixty-three month agreement through May 2015, renewable for an additional sixty months through April 2020. As of the date hereof, the Company has not committed to any facilities lease renewals.

Facility rent expense for the thirteen weeks ended June 29, 2013 and June 29, 2012 was \$569 and \$600, respectively. The Company's facility rent expense was inclusive of amounts charged from a related party during the thirteen weeks ended June 29, 2013 and June 29, 2012 of \$94 each period. Facility rent expense for the twenty-six weeks ended June 29, 2013 and June 29, 2012, was \$1,174 and \$1,183, respectively. The Company's facility rent expense was inclusive of amounts charged from a related party during the twenty-six weeks ended June 29, 2013 and June 29, 2012 of \$187 each period.

The following table summarizes the future minimum lease payments under non-cancellable operating leases as of June 29, 2013:

2013	\$ 1,120
2014	1,137
2015	1,120
2016	127
2017 and thereafter	
Total	\$ 3,504

On April 17, 2013, the Company's wholly-owned subsidiary, WAG closed the sale of its facility in LaSalle, Illinois. Under the terms of the purchase and sale agreement, simultaneously with the execution of the Agreement and the closing of the sale of the property, the Company entered into a lease agreement with STORE for 20 years commencing upon the execution of the lease and terminating on April 30, 2033. The Company's initial base annual rent is \$853 for the first year subject to an annual increase by the lesser of 1.5% or 1.25 times the change in the

Consumer Price Index. Refer to *Note 4 Property and Equipment, Net* for additional details.

Table of Contents

The following table summarizes the future minimum lease payments under the capital lease as of June 29, 2013:

2013	\$ 892
2014	891
2015	905
2016	913
2017	908
Thereafter	15,178
Total	\$ 19,687

Legal Matters

Asbestos. A wholly-owned subsidiary of the Company, Automotive Specialty Accessories and Parts, Inc. and its wholly-owned subsidiary WAG, are named defendants in several lawsuits involving claims for damages caused by installation of brakes during the late 1960 s and early 1970 s that contained asbestos. WAG marketed certain brakes, but did not manufacture any brakes. WAG maintains liability insurance coverage to protect its and the Company s assets from losses arising from the litigation and coverage is provided on an occurrence rather than a claims made basis, and the Company is not expected to incur significant out-of-pocket costs in connection with this matter that would be material to its consolidated financial statements.

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

Note 11 Employee Retirement Plan and Deferred Compensation Plan

Effective February 17, 2006, the Company adopted a 401(k) defined contribution retirement plan covering all full time employees who have completed one month of service. The Company may, at its sole discretion, match fifty cents per dollar up to 6% of each participating employee s salary. The Company s contributions vest in annual installments over three years. Discretionary contributions made by the Company totaled \$77 and \$92 for thirteen weeks ended June 29, 2013 and June 30, 2012, respectively. Discretionary contributions made by the Company totaled \$155 and \$171 for twenty-six weeks ended June 29, 2013 and June 30, 2012, respectively.

In January 2010, the Company adopted the U.S. Auto Parts Network, Inc. Management Deferred Compensation Plan (the Deferred Compensation Plan), for the purpose of providing highly compensated employees a program to meet their financial planning needs. The Deferred Compensation Plan provides participants with the opportunity to defer up to 90% of their base salary and up to 100% of their annual earned bonus, all of which, together with the associated investment returns, are 100% vested from the outset. The Deferred Compensation Plan, which is designed to be exempt from most provisions of the Employee Retirement Security Act of 1974, is informally funded by the Company through the purchase of Company-owned life insurance policies with the Company (employer) as the owner and beneficiary, in order to preserve the tax-deferred savings advantages of a non-qualified plan. The plan assets are the cash surrender value of the Company-owned life insurance policies and not associated with the deferred compensation liability. The deferred compensation liabilities (consisting of employer contributions, employee deferrals and associated earnings and losses) are general unsecured obligations of the Company. Liabilities under the Deferred Compensation Plan are recorded at amounts due to participants, based on the fair value of participants selected investments. The Company may at its discretion contribute certain amounts to eligible employee accounts. In January 2010, the Company began to contribute 50% of the first 2% of participants eligible contributions into their Deferred Compensation Plan accounts. In September 2010, the Company established and transferred its ownership to a rabbi trust to hold the Company-owned life insurance policies. As of June 29, 2013, the assets and associated liabilities of the Deferred Compensation Plan were \$827 and \$737, respectively, and are included in other non-current assets and other non-current liabilities, respectively, in our consolidated balance sheets. As of December 29, 2012, the assets and associated liabilities of the Deferred Compensation Plan were \$679 and \$651, respectively, and are included in other non-current assets and other non-current liabilities, respectively, in our consolidated balance sheets. For the thirteen weeks ended June 29, 2013, the associated liabilities mainly include the employee contributions of \$43 and the Company contributions of \$12. For the thirteen weeks ended June 30, 2012, the associated liabilities mainly include the employee contributions of \$49 and the Company contributions of \$10. For the thirteen weeks ended June 29, 2013 and June 30, 2012, included in other income, the Company recorded a net gain of \$6 and \$31, respectively, for the change in the cash surrender value of the Company-owned life insurance policies. For the twenty-six weeks ended June 29, 2013 and June 30, 2012, included in other income, net,

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

the Company recorded gain of \$24 and \$16, respectively, for the change in the cash surrender value of the Company-owned life insurance policies.

Table of Contents

Note 12 Restructuring Costs

As part of the Company's initiatives to reduce labor costs and improve operating efficiencies in response to the challenges in the marketplace and general market conditions, we reduced our workforce in the first quarter and second quarter of 2013. We laid off 13 employees in the United States and 163 employees in the Philippines reducing our workforce by a total of 176 employees in the first quarter of 2013 and 15 employees in the second quarter of 2013. For the thirteen weeks ended June 29, 2013, the severance charges of approximately \$225 were recorded in marketing expense, general and administrative expense, fulfillment expense and technology expense for \$140, \$15, \$17 and \$53, respectively. For the twenty-six weeks ended June 29, 2013, the severance charges of approximately \$723 were recorded in marketing expense, general and administrative expense, fulfillment expense and technology expense for \$394, \$109, \$58 and \$162, respectively. We do not expect to incur material additional charges subsequent to the second quarter of 2013. As of June 29, 2013, severance payable was \$162.

Note 13 Subsequent Events

On August 2, 2013, the Company, certain of its wholly-owned domestic subsidiaries and JPMorgan entered into a Third Amended Credit Agreement amending the Credit Agreement to, among other things, reduce the revolving commitment in an aggregate principal amount of up to \$20,000 and upon satisfaction of certain conditions, the Borrowers have the right to increase the revolving commitments up to and above \$40,000.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this report. Certain statements in this report, including statements regarding our business strategies, operations, financial condition, and prospects are forward-looking statements. Use of the words anticipates, believes, could, estimates, expects, intends, may, plans, potential, predicts, projects, should, will, would, will likely continue, will likely result and similar expressions that future events may identify forward-looking statements.

The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 29, 2012 and subsequent reports on Forms 10-Q and 8-K, which discuss our business in greater detail, which are available on the SEC's website at <http://www.sec.gov>. The section entitled Risk Factors set forth below in Part II, Item 1A of this report, and similar discussions in our other SEC filings, describe some of the important factors, risks and uncertainties that may affect our business, results of operations and financial condition and could cause actual results to differ materially from those expressed or implied by these or any other forward-looking statements made by us or on our behalf. You are cautioned not to place undue reliance on these forward-looking statements, which are based on current expectations and reflect management's opinions only as of the date thereof. We do not assume any obligation to revise or update forward-looking statements. Finally, our historic results should not be viewed as indicative of future performance.

Overview

We are one of the largest online providers of aftermarket auto parts, including body parts, engine parts, and performance parts and accessories. Our user-friendly websites provide customers with a broad selection of 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. Through AutoMD.com, the Company educates consumers on maintenance and service of their vehicles. The site provides auto information, with tools for diagnosing car troubles, locating repair shops and do-it-yourself (DIY) repair guides. Our flagship websites are located at www.autopartswarehouse.com, www.jcwhitney.com, www.AutoMD.com and our corporate website is located at www.usautoparts.net. We believe our strategy of disintermediating the traditional auto parts supply chain and selling products directly to customers over the Internet allows us to more efficiently deliver products to our customers while generating higher margins.

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

International Operations. In April 2007, we established offshore operations in the Philippines. Our offshore operations allow us to access a workforce with the necessary technical skills at a significantly lower cost than comparably experienced U.S.-based professionals. Our offshore operations are responsible for a majority of our website development, catalog management, and back office support. Our offshore operations also house our main call center. We had 768 employees in the Philippines as of June 29, 2013. In 2012, we shipped auto parts to over 160 different countries. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a cost-effective manner.

Acquisitions. From time to time, we may acquire certain businesses, websites, domain names, or other assets. In 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 increased our net sales and internet traffic. In August 2010, Go Fido, Inc., a wholly-owned subsidiary of ours, completed the purchase of all of the outstanding capital stock of Automotive Specialty Accessories and Parts, Inc. and its wholly-owned subsidiary Whitney Automotive Group, Inc. (referred to herein as WAG). WAG's Midwest facility expanded our distribution network and the merchandise WAG offers extended our go-to market product-lines into all terrain vehicles, recreational vehicles and motorcycles, as well as provides us with deep product knowledge into niche segments like Jeep, Volkswagen and trucks. This expansion of our product line increased our customer reach in the DIY automobile and off-road accessories market. We may pursue additional acquisition opportunities in the future to increase our share of the aftermarket auto parts market or expand our product offerings.

Table of Contents

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Unique Visitors (millions) ^{1,2}	\$ 35.1	\$ 43.0	\$ 71.8	\$ 90.9
Total Number of Orders (thousands)	523	635	1,052	1,340
Average Order Value	114	116	111	116
Revenue Capture	83.2%	84.4%	82.7	84.0

¹ Unique visitors do not include traffic from media properties (e.g. AutoMD).

² As we consolidate to a smaller number of websites, we changed the measurement source of our consolidated unique visitor data to a different third-party provider of that data in the first quarter of 2013. Previously reported operating metrics data was revised to conform to the current third-party provider's data.

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. During the second quarter of 2013, our unique visitors decreased by 18.4% compared to the second quarter of 2012. We expect declines in our unique visitors to continue in 2013 as we address the challenges we are experiencing from changes search engines have made to the formulas, or algorithms, that they use to optimize their search results, as described in further detail under *Executive Summary* below.

Total Number of Orders: We monitor the total number of orders as an indicator of future revenue trends. During the second quarter of 2013, the total number of orders was down by 17.6% compared to the second quarter of 2012 due to the decrease in unique visitors combined with overall increased competition. We expect the downward trend in the total number of orders to continue in 2013 due to continued declines in unique visitors and increased competition. 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. During the second quarter of 2013, our average order value decreased by 1.7% compared to the second quarter of 2012. We expect this trend to continue in 2013 primarily due to increased competition, as described in further detail under *Executive Summary* below. 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 competition online.

Revenue Capture: Revenue capture is the amount of actual dollars retained after taking into consideration returns, credit card declines and product fulfillment. During the second quarter of 2013, our revenue capture decreased by 1.2% to 83.2% compared to 84.4% in the second quarter of 2012. The decrease in revenue capture was due to credit card declines and product fulfillment in the second quarter of 2013 compared to the second quarter of 2012. We expect our revenue capture level to stay the same in 2013 as we continue to improve our customers' purchase experience.

Executive Summary

For the second quarter of 2013, the Company generated net sales of \$67.9 million, compared with \$80.7 million for the second quarter of 2012, representing a decrease of 15.9%. Net loss for the second quarter of 2013 was \$9.6 million, or \$0.29 per share. This compares to a net loss of \$1.7 million, or \$0.06 per share, for the second quarter of 2012. We generated net income (loss) before interest expense, net, income tax provision, depreciation and amortization expense, amortization of intangible assets, plus share-based compensation expense, impairment losses and restructuring costs (Adjusted EBITDA) of \$1.1 million in the second quarter of 2013 compared to \$3.7 million in the second quarter of 2012. Adjusted EBITDA is presented because such measure is used by rating agencies, securities analysts, investors and other parties in evaluating the Company. It should not be considered, however, as an alternative to operating income, as an indicator of the Company's operating

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

performance, or as an alternative to cash flows, as measures of the Company's overall liquidity, as presented in the Company's consolidated financial statements. Further, the Adjusted EBITDA measure shown for the Company may not be comparable to similarly titled measures used by other companies. Refer to the table presented below for reconciliation of net income (loss) to Adjusted EBITDA.

Table of Contents

Total revenues decreased in the second quarter of 2013 compared to the same period in 2012 primarily due to our decreased online sales. Our online sales, which include our e-commerce, online marketplace sales channels and online advertising, contributed 91.0% of total revenues, and our offline sales, which consist of our Kool-View and wholesale operations, contributed 9.0% of total revenues. Our online sales for the second quarter of 2013 decreased by \$12.9 million, or 17.3%, to \$61.8 million compared to \$74.7 million in the second quarter of 2012 primarily due to an 18.4% reduction in unique visitors. Our offline sales were flat compared to the same quarter last year.

Like most e-commerce retailers, our success depends on our ability to attract online consumers to our websites and convert them into customers in a cost-effective manner. Historically, marketing through search engines provided the most efficient opportunity to reach millions of on-line auto part buyers. We are included in search results through 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 websites. We decreased the amount we spent on paid search listings, as we have determined that it does not generate a sufficient amount of revenues to justify the expense. Algorithmic listings cannot be purchased and instead are determined and displayed solely by a set of formulas utilized by the search engine. We have had a history of success with our search engine marketing techniques, which gave our different websites preferred positions in search results. But search engines, like Google, revise their algorithms from time to time in an attempt to optimize their search results. Since 2011, Google has released changes to Google's search results ranking algorithm aimed to lower the rank of certain sites and return other sites near the top of the search results based upon the quality of the particular site as determined by Google. Google made additional updates throughout fiscal year 2012 and 2013. We were negatively impacted by the changes in methodology for how Google displayed or selected our different websites for customer search results. This reduced our unique visitor count which adversely affected our financial results. Our unique visitor count decreased by 7.9 million, or 18.4%, for the second quarter of 2013 to 35.1 million unique visitors compared to 43.0 million unique visitors in the second quarter of 2012. We believe we were affected by these search engine algorithm changes due to the use of our product catalog across multiple websites. To address this issue we are consolidating to a significantly smaller number of websites to ensure unique catalog content. As we are significantly dependent upon search engines for our website traffic, if we are unable to attract unique visitors, our business and results of operations will be harmed.

Barriers to entry in the automotive aftermarket industry are low, and current and new competitors can launch websites at a relatively low cost. We experienced significant competitive pressure from certain of our suppliers as they are now selling their products online. Since our suppliers have access to merchandise at very low costs, they were able to sell products at lower prices and maintain higher gross margins, thus our financial results were negatively impacted by the increased level of competition. Total orders for the second quarter of 2013 went down by 17.6% to 0.5 million compared to 0.6 million for the second quarter of 2012 and our average order value went down by \$2, or 1.7%, for the second quarter of 2013 to \$114 compared to \$116 in the second quarter of 2012 as a result of increased pricing competition. Our current and potential customers may decide to purchase directly from our suppliers. Continuing increased competition from our suppliers that have access to products at lower prices than us could result in reduced sales, lower operating margins, reduced profitability, loss of market share and diminished brand recognition. In addition, some of our competitors have used and may continue to use aggressive pricing tactics. We expect that competition will further intensify in the future as Internet use and online commerce continue to grow worldwide. We are taking a number of steps during 2013 to attempt to reduce the selling prices of our products while increasing margins, which are discussed below.

Total expenses decreased compared to the same period in 2012. Our expenses primarily consist of direct costs associated with procuring parts from suppliers and delivering products to customers, which include direct product costs, outbound freight and shipping costs, warehouse supplies and warranty costs, advertising expenses and personnel costs, as well as depreciation and amortization expense. Our personnel costs, which consist of compensation, benefits and payroll related taxes, and are primarily a function of our headcount, decreased in the second quarter of 2013 compared to the second quarter of 2012. Our employees at the end of the second quarter of 2013 decreased to 1,126 compared to 1,486 at the end of the second quarter of 2012. Our employees in the Philippines decreased to 768 at the end of the second quarter of 2013 compared to 973 at the end of the second quarter of 2012. In the first quarter and second quarter of 2013, as part of the Company's initiatives to reduce labor costs and improve operating efficiencies in response to the challenges in the marketplace and general market conditions, we reduced our workforce by 176 and 15 employees, respectively (for additional details, refer to *Note 12-Restructuring Costs* of the Notes to Consolidated Financial Statements, included in Part I, Item 1 of this report). In addition, our headcount decreased due to the closure of our call center operations in LaSalle, Illinois in August 2012. If the downward trend in our revenues and net loss continue for the remainder of 2013 and in 2014, we may be required to further reduce our labor costs. In addition, total expenses decreased in the second quarter of 2013 compared to the second quarter of 2012 primarily due to the decrease in direct costs resulting from lower revenues, reduction in online advertising expense, decrease in merchant fees due to lower online sales, and lower depreciation and amortization due to certain property and equipment and intangible assets that were impaired in the fourth quarter of 2012, partially offset by impairment losses on property and equipment and intangible assets during the second quarter of 2013.

Table of Contents

Overall, we expect the downward trend in our revenues and net loss to continue in 2013 primarily due to the factors mentioned above. This trend could severely impact our liquidity as we may not be able to provide positive cash flows from operations in order to meet our working capital requirements. We may need to borrow additional funds from our credit facility, which under certain circumstances may not be available, sell additional assets or seek additional equity or additional debt financing in the future. Refer to the *Liquidity and Capital Resources* section below for additional details. There can be no assurance that we would be able to raise such additional financing or engage in such asset sales on acceptable terms, or at all. If our expected downward trend in revenues and net loss continues for longer than we expect because our strategies to return to positive sales growth and profitability are not successful or otherwise, and if we are not able to raise adequate additional financing or proceeds from additional asset sales to continue to fund our ongoing operations, we will need to defer, reduce or eliminate significant planned expenditures, restructure or significantly curtail our operations.

Our strategies to return to positive sales growth and profitability are to attempt to accomplish the following in 2013:

Return to positive e-commerce growth by consolidating our websites to ensure unique catalog content and providing better content on our websites thereby improving our ranking on the search results. In addition, we intend to build mobile enabled websites to take advantage of shifting consumer behaviors. We expect this to increase unique visitors to our website and help us grow our revenues.

Improve the website purchase experience for our customers by (1) helping our customers find the parts they want to buy by reducing failed searches and increasing user purchase confidence; (2) selling more highly customized accessories by partnering with manufacturers to build custom shopping experiences; (3) increasing order size across our sites through improved recommendation engines; and (4) completing the roll out of high quality images and videos with emphasis on accessory product lines. We expect this to increase the conversion rate of our visitors to customers, total number of orders and average order value, and contribute to our revenue growth.

Become one of the lowest priced options in the market. We will lower our prices by increasing foreign sourced products as they provide more low-cost products. We expect this to improve the conversion rate for our visitors to our website, grow our revenues and improve our margins.

Increase product selection by being the first to market with new SKUs. We will seek to add new categories and expand our existing specialty categories. We expect this to increase the total number of orders and contribute to our revenue growth.

Be the consumer advocate for auto repair through AutoMD.com. We will continue to devote resources to AutoMD.com and its system development. We expect this to improve our brand recognition and contribute to our revenue growth.

As we redesign our approach to attracting customers through search engines, we hope to offset much of the revenue loss by pursuing revenue opportunities in third-party online marketplaces, a number of which are growing in excess of 10% per year. Auto parts buyers are finding third-party online marketplaces to be a very attractive environment, for many reasons, the top four being: (1) the security of their personal information; (2) the ability to easily compare product offerings from multiple sellers; (3) transparency (consumers can leave positive or negative feedback about their experience); and (4) favorable pricing. Successful selling in these third-party online marketplaces depends on product innovation, and strong relationships with suppliers, both of which we believe to be our core competencies.

There are various macro-economic factors that indirectly affect our business, including the impact of the recession, continued high unemployment and underemployment, and other challenging economic conditions. These factors decrease the overall discretionary spending of our customers and we believe it becomes more likely that consumers will keep their current vehicles longer, thus will need replacement parts as a result of general wear and tear, and perform repair and maintenance in order to keep those vehicles well maintained. At the same time, higher gas prices are negatively impacting the industry as consumers drive less and reduce the wear and tear on their vehicles. Given the nature of these factors, and the volatility of the overall economic environment, we cannot predict whether or for how long these trends will continue, nor can we predict to what degree these trends will impact us in the future.

Table of Contents

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Consolidated				
Net loss	\$ (9,567)	\$ (1,696)	\$ (12,910)	\$ (2,484)
Interest expense, net	226	183	411	382
Income tax provision	69	128	90	252
Amortization of intangibles	107	341	213	681
Depreciation and amortization	3,626	4,001	7,264	7,748
EBITDA	(5,539)	2,957	(4,932)	6,579

Share-based compensation