

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

(Mark One)

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

For the fiscal year ended January 1, 2011

OR

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

For the transition period from _____ to _____

Commission file number 001-33264

U.S. AUTO PARTS NETWORK, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

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

17150 South Margay Avenue, Carson, CA 90746
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (310) 735-0553

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, \$0.001 par value per share

Name of each exchange on which registered
The NASDAQ Stock Market LLC
(NASDAQ Global Market)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 Website, 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 a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of July 2, 2010 was approximately \$87,607,778 (based on the closing sales price of the registrant's common stock on that date). For the purposes of this calculation, shares owned by officers, directors and 10% stockholders known to the registrant have been deemed to be owned by affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 16, 2011, there were 30,449,376 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our proxy statement for the 2011 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as a part hereof.

[Table of Contents](#)

**U.S. AUTO PARTS NETWORK, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED JANUARY 1, 2011**

TABLE OF CONTENTS

	<u>Page</u>
<u>PART I</u>	
Item 1. Business	1
Item 1A. Risk Factors	4
Item 1B. Unresolved Staff Comments	17
Item 2. Properties	17
Item 3. Legal Proceedings	17
Item 4. Reserved	17
<u>PART II</u>	
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	17
Item 6. Selected Financial Data	20
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	21
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	40
Item 8. Financial Statements and Supplementary Data	41
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	41
Item 9A. Controls and Procedures	41
Item 9B. Other Information	43
<u>PART III</u>	
Item 10. Directors, Executive Officers and Corporate Governance	43
Item 11. Executive Compensation	43
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	43
Item 13. Certain Relationships and Related Transactions, and Director Independence	43
Item 14. Principal Accounting Fees and Services	43
<u>PART IV</u>	
Item 15. Exhibits, Financial Statement Schedules	44

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

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements included in this report, other than statements or characterizations of historical or current fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and we intend that such forward-looking statements be subject to the safe harbors created thereby. Any forward-looking statements included herein are based on management's beliefs and assumptions and on information currently available to management. We have attempted to identify forward-looking statements by terms such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "projects," "should," "will," "would", "will likely continue," "will likely result" and similar expressions. These forward-looking statements include, but are not limited to, statements regarding future events, our future operating and financial results, financial expectations, expected growth and strategies, current business indicators, capital needs, capital deployment, liquidity, contracts, litigation, product offerings, customers, acquisitions, competition and the status of our facilities. Forward-looking statements, no matter where they occur in this document or in other statements attributable to the Company involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. We discuss many of these risks in greater detail under the heading "Risk Factors" in Part I, 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.

PART I

ITEM 1. BUSINESS

Overview

We are one of the leading online sources for automotive aftermarket parts and repair information. Our vision is that vehicle owners never overpay for service and repair. Our mission is to be the service and repair advocate for vehicle owners, to increase their confidence in the repair process, and to provide the most affordable option for their service and repair needs.

We principally sell our products, identified as stock keeping units ("SKUs"), to individual consumers through our network of websites and online marketplaces. Our user-friendly websites provide customers with a comprehensive selection of approximately 1,800,000 SKUs with detailed product descriptions and photographs. We have developed a proprietary product database that maps our SKUs to product applications based on vehicle makes, models and years.

Our online sales channel and relationships with suppliers enable us to eliminate several intermediaries in the traditional auto parts supply chain and offer a broad selection of SKUs. Additionally, as an online retailer, we believe greater economies of scale can be achieved online than in brick and mortar stores.

We were incorporated in Delaware in 1995 as a distributor of aftermarket auto parts and launched our first website in 2000. Since then, we have continued to expand 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 on online marketplaces. In October 2008, we acquired AutoMD.com for the purpose of developing content and a user community to educate consumers on maintenance and service of their vehicles.

In August 2010, we acquired all of the issued and outstanding shares of Automotive Specialty Accessories and Parts ("WAG"), the nation's leading catalog and internet direct marketer of automotive aftermarket parts and accessories. This acquisition has expanded our product line into all terrain vehicles, recreational vehicles and motorcycles, as well as provided us deep product knowledge into niche segments like Jeep, Volkswagen and trucks. The expansion of our product line increases our ability to reach customers in the do-it-yourself, or DIY, automobile and off-road accessories market. Our flagship websites are located at www.autopartswarehouse.com, www.partstrain.com, www.jcwhitney.com, and www.stylintrucks.com and our corporate website is located at www.usautoparts.net.

Our Products

We offer a broad selection of aftermarket auto parts. We frequently refine our product offering by introducing new merchandise and updating the existing product selection to offer a more complete and relevant product line and to remove low-selling or obsolete SKUs. We broadly classify our products into three categories: body parts, engine parts, and performance parts and accessories.

[Table of Contents](#)

Body Parts. 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.

Engine/Hard 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.

Performance Parts and Accessories. 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.

Our Sales Channels

Our sales channels include the online channel and the offline channel.

Online Sales Channel. Our online sales channel consists of our e-commerce channel, online marketplaces and online advertising. Our e-commerce channel includes a network of e-commerce websites, supported by our call-center sales agents. We also sell our products through online marketplaces, including third-party auction sites and shopping portals, which provide us with access to additional consumer segments. The majority of our online sales are to individual consumers. Through online advertising, we sell advertising and sponsorship positions on our e-commerce websites to highlight vendor brands and offer complementary products and services that benefit our customers. Advertising is targeted to specific sections of the websites and can also be targeted to specific users based on the vehicles they drive. Advertising partners primarily include part vendors, national automotive aftermarket brands, and automobile manufacturers.

Offline Sales Channel. We sell and deliver to collision repair shops throughout Southern California via our offline sales channel. We also market our Kool-Vue™ products nationwide to auto parts wholesale distributors and serve consumers by operating retail outlet stores in Independence, Ohio and LaSalle, Illinois which were purchased through the acquisition of WAG.

Our Fulfillment Operations

We fulfill customer orders using two primary methods: (i) stock-and-ship, where we take physical delivery of merchandise and store it in one of our distribution centers until it is shipped to a customer, and (ii) drop-ship, where merchandise is shipped directly to customers from our suppliers. We believe that the flexibility of fulfilling orders using two different fulfillment methods allows us to offer a broader product selection, helps optimize product inventory and enhances our overall business profitability.

The selection of fulfillment methodology occurs at the time of order submission. When a customer submits an order, our fulfillment system performs a check on the ordered item to determine if it is in stock at any of our distribution centers. Fulfillment teams in our distribution centers then process orders for in-stock products. Orders for non-stocked products are sent to our suppliers and processed via drop-ship.

Stock-and-Ship Fulfillment. Our stock-and-ship products are sourced primarily from manufacturers and other suppliers located in Asia and in the U.S. and are stored in one of our distribution centers in Carson, California, Chesapeake, Virginia, LaSalle, Illinois, and Independence, Ohio. The distribution centers in LaSalle, Illinois and Independence, Ohio were purchased through the acquisition of WAG. All products received into our distribution centers are entered into our inventory management systems, allowing us to closely monitor inventory availability. We consider a number of factors in determining which items to stock in our distribution centers, including which products can be purchased at a meaningful discount to domestic prices for similar items, which products have historically sold in high volumes, and which products may be out of stock when we attempt to fulfill via drop-ship.

Drop-Ship Fulfillment. We have developed relationships with several U.S.-based automobile parts distributors that operate their own distribution centers and will deliver products directly to our customers. We internally developed a proprietary distributor selection system, Auto-Vend™, which allows us to electronically select multiple vendors for a given order. Auto-Vend™ will attempt to first direct an order to one of our warehouses. If the product is not in stock, Auto-Vend™ will process the order to the next appropriate vendor based on customer location, contractual agreements, and service level history.

[Table of Contents](#)

Suppliers

We source our products from foreign manufacturers and importers located in Taiwan and China, and from U.S. manufacturers and distributors. We drop-ship orders for low demand products manufactured in the U.S. directly from our manufacturers and distributors. We generally place large-volume orders with these suppliers and, as a result, may receive volume discounts on certain ordered products. Our domestic suppliers offer direct-to-customer shipping, allowing us to save on fulfillment costs and offer a broader selection of products. We have developed application programming interfaces with several of these suppliers that allow us to electronically transmit orders and check inventory availability. We are a significant customer for many of our drop-ship vendors and have long standing relationships and contracts with many of these suppliers. For the fiscal year ended January 1, 2011, one of our drop-ship vendors provided 17.3% of our total product purchases.

Marketing

Our online marketing efforts are designed to attract visitors to our websites, convert visitors into purchasing customers and encourage repeat purchases among our existing customer base. We use a variety of online marketing methods to attract visitors, including paid search advertising, search engine optimization, affiliate programs, e-mail marketing and inclusion in online shopping engines. To convert visitors into paying customers, we periodically run in-site promotions for discounted purchases. We seek to create cross-selling opportunities by displaying complementary and related products available for sale throughout the purchasing process. We utilize several marketing techniques, including targeted e-mails about specific vehicle promotions, to increase customer awareness of our products.

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, database management, catalog management, and search engine marketing technologies. Our offshore operations also house our call center. We have over 991 employees in the Philippines.

In addition to our operations in the Philippines, we have a Canadian subsidiary to facilitate sales of our products in Canada; the subsidiary has no distribution center or employees. We also ship parts directly to Canada and through a freight forwarding partner throughout the world. In 2010, we shipped auto parts to over 160 different countries.

Competition

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

- national auto parts retailers such as Advance Auto Parts, AutoZone, Napa Auto Parts, CarQuest, O’Reilly Automotive and Pep Boys
- large online marketplaces such as Amazon.com and sellers on eBay;
- other online retailers and auto repair information websites;
- local independent retailers or niche auto parts retailers; and
- wholesale aftermarket auto parts distributors such as LKQ Corporation.

We believe the principal competitive factors in our market are helping customers easily find their parts, educating consumers on the service and maintenance of their vehicles, maintaining a proprietary product catalog that maps individual parts to relevant vehicle applications, broad product selection and availability, price, knowledgeable customer service, and rapid order fulfillment and delivery. We believe we compete favorably on the basis of these factors. However, some of our competitors may be larger, have stronger brand recognition or may have access to greater financial, technical and marketing resources or have been operating longer than we have.

Table of Contents

Government Regulation

We are subject to federal and state consumer protection laws, including laws protecting the privacy of customer non-public information and the handling of customer complaints and regulations prohibiting unfair and deceptive trade practices. The growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens on online companies. These laws may cover issues such as user privacy, spyware and the tracking of consumer activities, marketing e-mails and communications, other advertising and promotional practices, money transfers, pricing, content and quality of products and services, taxation, electronic contracts and other communications and information security. In addition, most states have passed laws that prohibit or limit the use of aftermarket auto parts in collision repair work and/or require enhanced disclosure or vehicle owner consent before using aftermarket auto parts in such repair work and additional legislation of this kind may be introduced in the future.

There is also great uncertainty over whether or how existing laws governing issues such as property ownership, sales and other taxes, auctions, libel and personal privacy apply to the Internet and commercial online services. These issues may take years to resolve. For example, tax authorities in a number of states, as well as a Congressional advisory commission, are currently reviewing the appropriate tax treatment of companies engaged in online commerce, and new state tax regulations may subject us to additional state sales and income taxes. New legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of existing laws and regulations to the Internet and commercial online services could result in significant additional taxes or regulatory restrictions on our business. These taxes or restrictions could have an adverse effect on our cash flows and results of operations. Furthermore, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements.

Environmental

We are subject to environmental regulation as it affects certain of the products we sell. For instance, California currently only allows catalytic converters approved by the state to be sold within the state and, during 2010 and early 2011, the Company met with the California Air Resources Board ("CARB") to discuss alleged sales of catalytic converters into California by the Company and third-party suppliers that are not compliant with California regulations. CARB informed the Company that penalties may be assessed with regard to any non-compliant sales; discussions are ongoing, and any penalties are not estimable at this time but are not expected to be significant in amount. There has been an indication that thirteen other states may be pursuing the enactment of similar regulations. In addition, if we expanded our product lines, we may be subject to additional environmental regulation.

Seasonality

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

Employees

As of January 31, 2011, we had 621 employees in the United States and 991 employees in the Philippines for a total of 1,612 employees. None of our employees are represented by a labor union, and we have never experienced a work stoppage.

Available Information

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports are available free of charge on the Investor Relations section of our corporate website located at www.usautoparts.net as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC"). The inclusion of our website address in this report does not include or incorporate by reference into this report any information on our website.

ITEM 1A. RISK FACTORS

Our business is subject to a number of risks which are discussed below. Other risks are presented elsewhere in this report and in the information incorporated by reference into this report. You should consider carefully the following risks in addition to the other information contained in this report and our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K, and any amendments thereto, before deciding to buy, sell or hold our common stock. If any

Table of Contents

of these known or unknown risks or uncertainties actually occurs with material adverse effects on us, our business, financial condition, results of operations and/or liquidity could be seriously harmed. In that event, the market price for our common stock will likely decline and you may lose all or part of your investment.

Risks Related To Our Business

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

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

- concerns about buying auto parts without face-to-face interaction with sales personnel;
- the inability to physically handle, examine and compare products;
- delivery time associated with Internet orders;
- concerns about the security of online transactions and the privacy of personal information;
- delayed shipments or shipments of incorrect or damaged products;
- increased shipping costs; and
- the inconvenience associated with returning or exchanging items purchased online.

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

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

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

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

As part of our growth strategy, we acquired WAG on August 12, 2010 and we expect that we will selectively pursue additional acquisitions of businesses, technologies or services in order to expand our capabilities, enter new markets or increase our market share. In conjunction with the acquisition of WAG, we recorded a significant valuation allowance against our deferred tax asset, and have incurred greater than usual legal and accounting fees, as well as general and administrative expenses. Additionally, because the acquisition of WAG was a stock purchase, we may incur liability for acts taken prior to

Table of Contents

our acquisition that may involve costly litigation. Integrating any newly acquired businesses' websites, technologies or services is likely to be expensive and time consuming or other liabilities. For example, our acquisition of All OEM Parts, Inc., the Partsbin.com, Inc., and other affiliated companies (collectively "Partsbin"), resulted in significant costs, including a material impairment charge, a write-down of goodwill associated with the acquisition, and a number of challenges, including retaining employees of the acquired company, integrating our order processing and credit processing, integrating our product pricing strategy, and integrating the diverse technologies and differing e-commerce platforms and accounting systems used by each company. Our integration activities in connection with our acquisitions have also caused a substantial diversion of our management's attention. If we are unable to successfully complete the integration of acquisitions, including WAG, we may not realize the anticipated synergies from such acquisitions, we may take impairment charges and write-downs associated with such acquisitions, and our business and results of operations could suffer. In connection with the acquisition of WAG, we incurred acquisition and integration related costs of \$3.1 million. To finance any future acquisitions, it may also be necessary for us to raise additional capital through public or private financings or to obtain additional bank financing. Additional funds may not be available on terms that are favorable to us, and, in the case of equity financings, would result in dilution to our stockholders. Future acquisitions by us could also result in assumption of debt and unforeseen liabilities (including our becoming involved in litigation relating to any business we acquire) and significant adverse accounting charges, any of which could substantially harm our business, financial condition and results of operations.

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

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

- the key personnel of the acquired company may decide not to work for us;
- customers of the acquired company may decide not to purchase products from us;
- we may experience business disruptions as a result of information technology systems conversions;
- we may experience additional financial and accounting challenges and complexities in areas such as tax planning, treasury management, and financial reporting;
- we may be held liable for environmental, tax or other risks and liabilities as a result of our acquisitions, some of which we may not have discovered during our due diligence;
- we may intentionally assume the liabilities of the companies we acquire, which could materially and adversely affect our business;
- our ongoing business may be disrupted or receive insufficient management attention;
- we may not be able to realize the cost savings or other financial benefits or synergies we anticipated, either in the amount or in the time frame that we expect; and
- we may incur debt or issue equity securities to pay for any future acquisition, the issuance of which could involve the imposition of restrictive covenants or be dilutive to our existing stockholders.

Our operations are restricted by our credit facility.

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

- incur additional debt;
- make certain investments and acquisitions;
- enter into certain types of transactions with affiliates;
- use assets as security in other transactions;
- pay dividends on our capital stock or repurchase our equity interests;
- sell certain assets or merge with or into other companies;
- guarantee the debts of others;
- enter into new lines of business;

Table of Contents

- pay or amend our subordinated debt;
- form any joint ventures or subsidiary investments.

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

Our ability to comply with the covenants and other terms of our debt obligations will depend on our future operating performance. If we fail to comply with such covenants and terms, we would be required to obtain waivers from our lenders to maintain compliance with our debt obligations. As of January 1, 2011, in connection with the Company's credit facility, the Company's Consolidated Fixed Charge Coverage ratio was lower than the ratio required by the covenants in the Loan and Security Agreement entered into by and between the Company and Silicon Valley Bank ("Bank") on August 13, 2010 ("LSA"). On February 28, 2011, the Company and the Bank, entered into Amendment No. 1 to Loan and Security Agreement and Limited Waiver ("Amendment"). The Amendment waived the Company's non compliance with the Consolidated Fixed Charge Coverage Ratio Covenant in the LSA. The Amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA (earnings before income tax, depreciation and amortization) to more readily accommodate the Company's integration of the WAG acquisition. If we are unable to obtain any necessary waivers and the debt is accelerated, a material adverse effect on our financial condition and future operating performance would result. Additionally, our indebtedness could have important consequences, including the following:

- We will have to dedicate a portion of our cash flow to making interest and principal payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions or other general corporate purposes.
- Certain levels of indebtedness may make us less attractive to potential acquirers or acquisition targets.
- Certain levels of indebtedness may limit our flexibility to adjust to changing business and market conditions, and make us more vulnerable to downturns in general economic conditions as compared to competitors that may be less leveraged.
- As described in more detail above, the documents providing for our indebtedness contain restrictive covenants that may limit our financing and operational flexibility.

Furthermore, our ability to satisfy our debt service obligations will depend, among other things, upon fluctuations in interest rates, our future operating performance and ability to refinance indebtedness when and if necessary. These factors depend partly on economic, financial, competitive and other factors beyond our control. We may not be able to generate sufficient cash from operations to meet our debt service obligations as well as fund necessary capital expenditures and general operating expenses. In addition, if we need to refinance our debt, or obtain additional financing or sell assets or equity to satisfy our debt service obligations, we may not be able to do so on commercially reasonable terms, if at all.

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

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

- the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our business, operations and infrastructure;
- difficulties and costs of staffing and managing foreign operations;
- restrictions imposed by local labor practices and laws on our business and operations;
- exposure to different business practices and legal standards;
- unexpected changes in regulatory requirements;
- the imposition of government controls and restrictions;
- political, social and economic instability and the risk of war, terrorist activities or other international incidents;
- the failure of telecommunications and connectivity infrastructure;
- natural disasters and public health emergencies;

Table of Contents

- potentially adverse tax consequences;
- the failure of local laws to provide a sufficient degree of protection against infringement of our intellectual property; and
- fluctuations in foreign currency exchange rates and relative weakness in the U.S. Dollar.

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

We acquire substantially all of our products from manufacturers and distributors located in Taiwan, China and the United States. Our top ten suppliers represented approximately 58% of our total product purchases during the fifty-two weeks ended January 1, 2011 (“fiscal 2010”). We do not have any long-term contracts or exclusive agreements with our foreign suppliers that would ensure our ability to acquire the types and quantities of products we desire at acceptable prices and in a timely manner. In addition, our ability to acquire products from our suppliers in amounts and on terms acceptable to us is dependent upon a number of factors that could affect our suppliers and which are beyond our control. For example, financial or operational difficulties that some of our suppliers may face could result in an increase in the cost of the products we purchase from them. In addition, the increasing consolidation among auto parts suppliers may disrupt or end our relationship with some suppliers, result in product shortages and/or lead to less competition and, consequently, higher prices.

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

- political, social and economic instability and the risk of war or other international incidents in Asia or abroad;
- fluctuations in foreign currency exchange rates that may increase our cost of products;
- tariffs and protectionist laws and business practices that favor local businesses;
- difficulties in complying with import and export laws, regulatory requirements and restrictions; and
- natural disasters and public health emergencies.

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

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

For a number of the products that we sell, we outsource the distribution and fulfillment operation and are dependent on our distributors to manage inventory, process orders and distribute those products to our customers in a timely manner. For fiscal 2010, our product purchases from a single supplier represented 17.3% of our total product purchases. If we do not maintain our existing relationships with this supplier and our other distributors on acceptable commercial terms, we will need to obtain other suppliers and may not be able to continue to offer a broad selection of merchandise at competitive prices, and our sales may decrease.

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

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

Table of Contents

- large online marketplaces such as Amazon.com and eBay;
- other online retailers;
- local independent retailers or niche auto parts online retailers; and
- wholesale aftermarket auto parts distributors such as LKQ Corporation.

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

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

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

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

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

Original equipment manufacturers have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEMs have brought such claims in federal court and with the United States International Trade Commission. We have received in the past, and we anticipate we may in the future receive, communications alleging that certain products we sell infringe the patents, copyrights, trademarks and trade names or other intellectual property rights of OEMs or other third parties. For instance, after the three and a half years of litigation and related costs and expenses, on April 16, 2009, we entered into a settlement agreement with Ford Motor Company and Ford Global Technologies, LLC that ended the two legal actions that were initiated by Ford against us.

The United States Patent and Trademark Office records indicate that OEMs are seeking and obtaining more design patents than they have in the past. To the extent that the OEMs are successful with intellectual property infringement claims, we could be restricted or prohibited from selling certain aftermarket products which could have an adverse effect on our business. Infringement claims could also result in increased costs of doing business arising from increased legal expenses, adverse judgments or settlements or changes to our business practices required to settle such claims or satisfy any judgments. Litigation could result in interpretations of the law that require us to change our business practices or otherwise increase our costs and harm our business. We do not maintain insurance coverage to cover the types of claims that could be asserted. If a successful claim were brought against us, it could expose us to significant liability.

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

We regard our trademarks, trade secrets and similar intellectual property such as our proprietary back-end order processing and fulfillment code and process as important to our success. We rely on trademark and copyright law, and trade secret protection, and confidentiality and/or license agreements with employees, customers, partners and others to protect our proprietary rights. We cannot be certain that we have taken adequate steps to protect our proprietary rights, especially in countries where the laws may not protect our rights as fully as in the United States. In addition, our proprietary rights may be infringed or misappropriated, and we could be required to incur significant expenses to preserve them. For instance, on

Table of Contents

June 25, 2009, we filed a lawsuit in United States District Court, Central District of California against PartsGeek LLC, its members and several of its employees, alleging, among other things, misappropriation of trade secrets, breach of contract and unfair competition. We are requesting both monetary and injunctive relief. The outcome of such litigation is uncertain, and the cost of prosecuting the litigation may have an adverse impact on our earnings. We have common law trademarks, as well as pending federal trademark registrations for several marks and three registered marks. Even if we obtain approval of such pending registrations, the resulting registrations may not adequately cover our intellectual property or protect us against infringement by others. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our products and services may be made available online. We also currently own or control a number of Internet domain names, including www.usautoparts.net, www.autopartswarehouse.com, www.partstrain.com, www.jcwhitney.com, and www.stylintrucks.com, and have invested time and money in the purchase of domain names and other intellectual property, which may be impaired if we cannot protect such intellectual property. We may be unable to protect these domain names or acquire or maintain relevant domain names in the United States and in other countries. If we are not able to protect our trademarks, domain names or other intellectual property, we may experience difficulties in achieving and maintaining brand recognition and customer loyalty.

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

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

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

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

We face exposure to product liability lawsuits.

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

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

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

Table of Contents

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

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

- prevent customers from accessing our websites;
- reduce our ability to fulfill orders or bill customers;
- reduce the number of products that we sell;
- cause customer dissatisfaction; or
- damage our brand and reputation.

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

Risks Related To Our Common Stock

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

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

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

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

As of January 1, 2011, our executive officers and directors and entities that are affiliated with them beneficially owned in the aggregate approximately 45.3% of our outstanding shares of common stock. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. Also, these stockholders, acting together, will be able to significantly influence our management and affairs and matters requiring stockholder approval including the election of our entire Board of Directors and certain significant corporate actions such as mergers, consolidations or the sale of substantially all of our assets. As a result, this concentration of ownership could delay, defer or prevent others from initiating a potential merger, takeover or other change in our control, even if these actions would benefit our other stockholders and us.

[Table of Contents](#)

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

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

- fluctuations in the demand for aftermarket auto parts;
- price competition on the Internet or among offline retailers for auto parts;
- our ability to attract visitors to our websites and convert those visitors into customers;
- our ability to maintain and expand our supplier and distribution relationships without significant price increases or reduced service levels;
- the effects of seasonality on the demand for our products;
- our ability to accurately forecast demand for our products, price our products at market rates and maintain appropriate inventory levels;
- our ability to build and maintain customer loyalty;
- our ability to successfully integrate our acquisitions;
- infringement actions that could impact the viability of the auto parts aftermarket or portions thereof;
- the success of our brand-building and marketing campaigns;
- our ability to accurately project our future revenues, earnings, and results of operations;
- government regulations related to use of the Internet for commerce, including the application of existing tax regulations to Internet commerce and changes in tax regulations;
- technical difficulties, system downtime or Internet brownouts;
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure; and
- the impact of adverse economic conditions on retail sales, in general.

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

While management has concluded that our internal controls over financial reporting were effective as of January 1, 2011, we have in the past, and could in the future, have a material weakness or significant deficiency in our control over financial reporting or fail to comply with Section 404 of the Sarbanes-Oxley Act of 2002. If we fail to properly maintain an effective system of internal control over financial reporting, it could impact our ability to prevent fraud or to issue our financial statements in a timely manner that presents fairly our financial condition and results of operations. The existence of any such deficiencies or weaknesses, even if cured, may also lead to the loss of investor confidence in the reliability of our financial statements, could harm our business and negatively impact the trading price of our common stock. Such deficiencies or material weaknesses may also subject us to lawsuits, investigations and other penalties.

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

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

- our Board of Directors are authorized, without prior stockholder approval, to create and issue preferred stock which could be used to implement anti-takeover devices;
- advance notice is required for director nominations or for proposals that can be acted upon at stockholder meetings;
- our Board of Directors is classified such that not all members of our board are elected at one time, which may make it more difficult for a person who acquires control of a majority of our outstanding voting stock to replace all or a majority of our directors;
- stockholder action by written consent is prohibited except with regards to an action that has been approved by the Board;

Table of Contents

- special meetings of the stockholders are permitted to be called only by the chairman of our Board of Directors, our chief executive officer or by a majority of our Board of Directors;
- stockholders are not permitted to cumulate their votes for the election of directors; and
- stockholders are permitted to amend certain provisions of our bylaws only upon receiving at least 66 2/3% of the votes entitled to be cast by holders of all outstanding shares then entitled to vote generally in the election of directors, voting together as a single class.

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

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

General Market and Industry Risk

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

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

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

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

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

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

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

Our investment securities consist of high-grade auction rate preferred securities ("ARPS"). As of January 1, 2011, our long-term marketable securities were comprised of \$4.2 million (par value) of high-grade (AAA rated) ARPS issued primarily by closed end funds that primarily hold debt obligations from municipalities. The recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings, including their holdings of ARPS. In response to the credit situation, in February 2008, we instructed our investment advisor to liquidate all our investments in closed end funds and move these funds into money market investments but there was insufficient demand at auction for our

Table of Contents

remaining four high-grade ARPS, representing approximately \$7.8 million at that time. As a result, these affected securities currently are not liquid, and have been reclassified as long-term investments. For the period June 30, 2008 through January 1, 2011, an additional \$3.5 million of our investments in ARPS were redeemed but we do not know when we will have access to the capital in these remaining investments. In the event we need to access the funds that are in an illiquid state, we will not be able to do so without a loss of principal or until a future auction on these investments is successful, the securities are redeemed by the issuer or a secondary market emerges. If we cannot readily access these funds, we may be required to borrow funds or issue additional debt or equity securities to meet our capital requirements. As of January 1, 2011, management concluded that these remaining investments were temporarily impaired and has recognized an unrealized loss in other comprehensive income totaling \$0.1 million. Management is not sure that these investments will not be settled in the short term, although the market for these investments is presently uncertain. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an additional impairment charge.

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

[Table of Contents](#)

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of January 1, 2011, the square footage of our leased and owned office and warehouse space was 402,000 and 347,000, respectively. Our corporate headquarters and primary distribution centers are located in Carson, California and LaSalle, Illinois in approximately 485,000 square feet of office and warehouse space. We have a 130,000 square foot distribution center in Chesapeake, Virginia. We currently lease approximately 43,000 square feet of office space in the Philippines for our employees located in that country. In August 2010, we assumed the leases of office and warehouse space originally entered by WAG. The leased properties are located in Independence, Ohio and Chicago, Illinois and are approximately 61,000 and 22,000 square feet, respectively. For additional information regarding our obligations under property leases, see "Note 13-Commitments and Contingencies" of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report.

ITEM 3. LEGAL PROCEEDINGS

The information set forth under the caption "Legal Matters" in Note 13 of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled "Risk Factors" in Item 1A of this report.

ITEM 4. RESERVED

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is being trading on the NASDAQ Global Market under the symbol "PRTS." The table below sets forth the high and low sales prices of our common stock for the periods indicated:

	<u>High</u>	<u>Low</u>
Quarter ended April 4, 2009	\$1.80	\$1.01
Quarter ended July 4, 2009	4.13	1.61
Quarter ended October 3, 2009	6.35	3.53
Quarter ended January 2, 2010	6.24	4.28
Quarter ended April 3, 2010	7.65	5.11
Quarter ended July 3, 2010	9.40	6.00
Quarter ended October 2, 2010	9.04	5.92
Quarter ended January 1, 2011	9.07	7.73

On March 16, 2011, the last reported sale price of our common stock on the NASDAQ Global Market was \$6.75 per share.

Holders

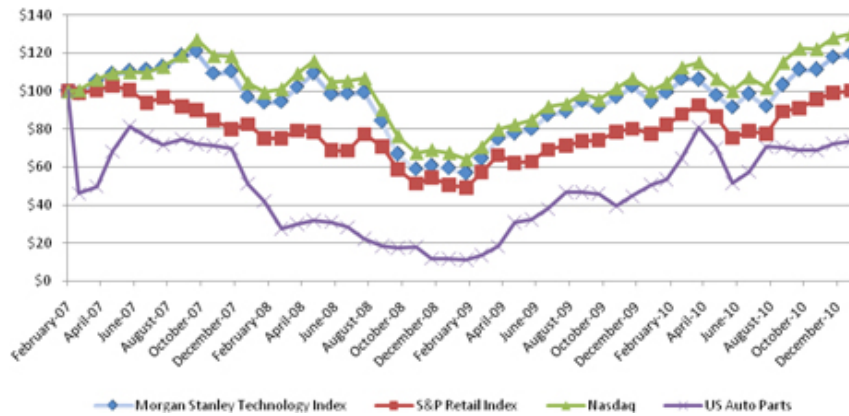
As of March 11, 2011, there were approximately 720 non-objecting holders of record of our common stock.

[Table of Contents](#)

Stock Performance Graph

The material in this section is not “soliciting material,” is not deemed “filed” with the SEC, and shall not be deemed to be incorporated by reference into any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

The following graph shows a comparison of the total cumulative returns of an investment of \$100 in cash on February 9, 2007, the first trading day following our initial public offering in (i) our common stock, (ii) the Morgan Stanley Technology Index, (iii) the S&P 500 Retail Index and (iv) NASDAQ Composite Index, in each case through January 1, 2011. The comparisons in the graph are required by the SEC and are not intended to forecast or be indicative of the possible future performance of our common stock. The graph assumes that all dividends have been reinvested (to date, we have not declared dividends).



Dividend Policy

No dividends were paid during the fifty-two weeks ended January 2, 2010 and January 1, 2011. We currently intend to retain any future earnings to finance the growth and development of our business, and we do not anticipate that we will declare or pay any cash dividends on our common stock in the foreseeable future. In August 2010, the Company and Silicon Valley Bank entered into a Loan and Security Agreement and other definitive documentation for a \$35 million secured credit facility. The Loan and Security Agreement requires us to obtain a prior written consent from Silicon Valley Bank when we determine to pay any dividends on or make any distribution with respect to our common stock. See “*Liquidity and Capital Resources*” in Item 7 of Part II included in this report for further information on the covenants under the secured credit facility. Any future determination to pay cash dividends will be subject to the above restriction as well as restrictions under any other existing indebtedness at the discretion of our Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, and other factors the Board of Directors deems relevant.

Sales of Unregistered Securities

None.

Use of Proceeds from Sales of Registered Securities

On February 14, 2007, we completed the initial public offering of our common stock, pursuant to which we sold 8,000,000 shares of our common stock and the selling stockholders sold an aggregate of 3,500,000 shares of our common stock (which included 1,500,000 shares sold by the selling stockholders pursuant to the exercise of the underwriters’ over-allotment option) at the initial public offering price of \$10.00 per share. The shares of common stock sold in the offering were registered under the Securities Act on a registration statement on Form S-1 (File No. 333-138379) that was declared effective by the SEC on February 8, 2007. RBC Capital Markets Corporation, Thomas Weisel Partners LLC, Piper Jaffray & Co., and JMP Securities LLC were the co-managing underwriters for the offering.

Table of Contents

The aggregate purchase price of the shares sold by us in the offering was \$80.0 million. The aggregate purchase price of the shares sold by the selling stockholders was \$35.0 million. We and the selling stockholders paid to the underwriters underwriting discounts and commissions totaling \$5.6 million and \$2.5 million, respectively, in connection with the offering. In addition, we incurred additional expenses of approximately \$2.9 million in connection with the offering. After deducting the underwriting discounts and commissions and offering expenses, we received net proceeds from the offering of approximately \$71.5 million. We did not receive any proceeds from the sale of shares by the selling stockholders.

Approximately \$28.0 million of the net proceeds from the offering was used to repay our outstanding indebtedness under two term loans for approximately \$18.0 million and \$10.0 million, payable to our commercial lender. In addition, \$5.0 million of the net proceeds from the offering was paid on the notes payable to the former stockholders of Partsbin. Except for the payment of such debt, none of the net proceeds from the offering were paid directly or indirectly to any of our directors or officers (or their associates) or persons owning ten percent or more of any class of our equity securities or to any other affiliate, other than in the form of wages or salaries and bonuses paid out in the ordinary course of business. In March 2007, a class action lawsuit was filed alleging violations of federal securities law in connection with our initial public offering. The Company entered into a settlement agreement in this regard in May 2008. In July 2008, the Company funded the settlement consideration to an escrow account totaling \$3.4 million which was court approved in October 2008 and subsequently disbursed. The remaining net proceeds from the offering have been invested in investment-grade securities, and acquisitions of assets and businesses.

Purchases of Equity Securities by the Issuer and Affiliated Purchaser

We did not repurchase any of our outstanding equity securities during the most recent quarter covered by this report.

[Table of Contents](#)

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial information as of and for the dates and periods indicated have been derived from our audited consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Part II, Item 7 of this report and our consolidated financial statements and related notes included elsewhere in this report.

	Year Ended December 31, 2006 ("calendar year 2006") (1)	Year Ended December 31, 2007 ("calendar year 2007")(2)	Year Ended December 31, 2008 ("calendar year 2008")(3)	52 Weeks Ended January 2, 2010 ("fiscal 2009")	52 Weeks Ended January 1, 2011 ("fiscal 2010")(4)
(in thousands, except share and per share data)					
Consolidated Statements of Operations Data:					
Net sales	\$ 120,060	\$ 160,957	\$ 153,424	\$ 176,288	\$ 262,277
Cost of sales	<u>78,573</u>	<u>107,132</u>	<u>100,869</u>	<u>112,415</u>	<u>172,668</u>
Gross profit	41,487	53,825	52,555	63,873	89,609
Operating expenses:					
Marketing	15,102	21,551	22,965	23,419	38,757
General and administrative	9,594	18,587	18,234	19,640	28,628
Fulfillment	4,963	7,557	9,116	11,437	14,946
Technology	1,332	1,987	3,642	4,467	5,902
Amortization of intangibles and impairment loss	5,092	8,350	23,896	661	2,804
Impairment loss on goodwill	<u>—</u>	<u>—</u>	<u>4,430</u>	<u>—</u>	<u>—</u>
Total operating expenses	36,083	58,032	82,283	59,624	91,037
Income (loss) from operations	5,404	(4,207)	(29,728)	4,249	(1,428)
Other (expense) income, net	<u>(1,358)</u>	<u>1,148</u>	<u>1,000</u>	<u>191</u>	<u>(280)</u>
Income (loss) before income taxes	4,046	(3,059)	(28,728)	4,440	(1,708)
Income tax provision (benefit)	<u>550</u>	<u>538</u>	<u>(11,822)</u>	<u>3,123</u>	<u>12,218</u>
Net income (loss)	<u>\$ 3,496</u>	<u>\$ (3,597)</u>	<u>\$ (16,906)</u>	<u>\$ 1,317</u>	<u>\$ (13,926)</u>
Basic net income (loss) per share	\$ 0.24	\$ (0.13)	\$ (0.57)	\$ 0.04	\$ (0.46)
Diluted net income (loss) per share	\$ 0.17	\$ (0.13)	\$ (0.57)	\$ 0.04	\$ (0.46)
Shares used in computation of basic net income					
(loss) per share	14,437,657	28,274,022	29,846,757	29,851,873	30,269,462
Shares used in computation of diluted net income					
(loss) per share	19,990,431	28,274,022	29,846,757	30,809,111	30,269,462

- (1) Calendar year 2006 includes the results of Partsbin, which was acquired in May 2006, and is not reflected in prior periods.
- (2) Calendar year 2007 includes a reserve of \$4.5 million for the securities litigation settlement fee and associated expenses.
- (3) Calendar year 2008 includes a \$23.4 million non-cash impairment charge on goodwill and intangible assets.
- (4) Fiscal 2010 includes the results of WAG which was acquired in August 2010, and is not reflected in prior periods. During fiscal 2010, the net sales of \$39.1 million and the net loss of \$6.0 million of WAG were included in the consolidated statement of operations since the acquisition date of August 12, 2010. Also the recognition of \$13.6 million valuation allowance for deferred income tax assets was included in fiscal 2010. The total valuation allowance recorded during the year was \$18.3 million, of which \$4.7 million was recorded as a reduction to the value of the acquired deferred tax assets of WAG recorded as part of the purchase accounting for WAG.

[Table of Contents](#)

	Year Ended December 31, 2006	Year Ended December 31, 2007	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
(in thousands)					
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 2,381	\$ 19,399	\$ 32,473	\$ 26,251	\$ 17,595
Working (deficit) capital (1)	(11,213)	40,421	36,013	42,049	20,688
Total assets (2)	69,910	110,056	90,430	104,614	153,537
Notes payable to stockholders	5,000	1,000	—	—	—
Long-term debt (excluding notes payable to stockholders and current portion)	20,786	48	—	—	18,060
Stockholders' equity	20,612	91,643	77,522	82,687	72,804

- (1) Calendar year 2008 excludes \$6.5 million of investments which were reclassified to long-term due to illiquidity in the market. Additionally, fiscal 2009 and fiscal 2010 exclude \$4.3 million and \$4.1 million, respectively, of the same investments.
- (2) Fiscal 2010 includes a deferred income tax asset valuation allowance of \$18.3 million that is netted against the total assets as of January 1, 2011.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read together with our consolidated financial statements and related notes included in Part IV, Item 15 of this report. This discussion contains forward-looking statements that involve risks and uncertainties. As a result of many factors, such as those set forth under the section entitled "Risk Factors" in Item 1A and elsewhere in this report, our actual results may differ materially from those anticipated in these forward-looking statements.

We are one of the largest online providers of aftermarket auto parts, including body parts, engine parts, and performance parts and accessories. Our user-friendly websites provide customers with a broad selection of Stock Keeping Units, or SKUs, with detailed product descriptions and photographs. Our proprietary product database maps our SKUs to product applications based on vehicle makes, models and years. We principally sell our products to individual consumers through our network of websites and online marketplaces. Our flagship websites are located at www.autopartswarehouse.com, www.partstrain.com, www.jcwhitney.com, www.stylintrucks.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, acquiring the Partsbin, improving our Internet marketing proficiency and commencing sales in online marketplaces. Additionally, in August 2010, through our acquisition of WAG, we expanded our product-lines and increased our customer reach in the do-it-yourself automobile and off-road accessories market. As a result, our business has grown since 2000, generating net sales of \$262 million for fiscal 2010.

International Operations. In April 2007, we entered into a purchase agreement to bring in-house certain sales and customer service employees based in the Philippines, who were providing support to us through our outsourced call center provider, Access Worldwide. As of the closing of this transaction, approximately 171 of the Access Worldwide employees had agreed to transition over to direct employment by our Philippines subsidiary. The purchase price for the right to acquire this assembled workforce was approximately \$1.7 million. We had 991 employees in our Philippines operations as of January 31, 2011. In addition to our Philippines operations, we own a Canadian subsidiary to facilitate sales of our products in Canada which currently has no employees. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a cost-effective manner, and we expect to continue to add headcount and infrastructure to our offshore operations.

Acquisitions. From time to time, we may acquire certain businesses, websites, domain names, or other assets. In the third quarter of fiscal 2009, we completed the acquisition of the assets of a small website and the related domain names which further expanded and enhanced our product offering and our ability to reach more customers. In the first quarter of fiscal 2010, we completed two additional website and domain name asset acquisitions, which we expect will increase our net

[Table of Contents](#)

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, or WAG. WAG's state-of-the-art Midwest facility expands our distribution network and the merchandise WAG offers extends our go to market product-lines into all terrain vehicles, recreational vehicles and motorcycles, as well as provides us with deep product knowledge into niche segments like Jeep, Volkswagen and trucks. This expansion of our product line increases our customer reach in the do-it-yourself automobile and off-road accessories market. For additional information, see "*Note 5 – Business Combination*" of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report. We may pursue additional acquisition opportunities in the future to increase our share of the aftermarket auto parts market or expand our product offering.

[Table of Contents](#)

Executive Summary

Our net sales for fiscal 2010 were \$262.3 million, compared with \$176.3 million for fiscal 2009. Excluding \$39.1 million of sales from WAG, net sales for fiscal 2010 were \$223.2 million, an increase of 27% over fiscal 2009 net sales. Net loss for fiscal 2010 was \$13.9 million, or \$0.46 per share, which includes non-cash deferred income tax asset valuation reserve of \$13.6 million or \$0.45 per share, \$3.1 million or \$0.10 per share of restructuring charges related to WAG, and \$2.3 million or \$0.08 per share of legal expenses to protect intellectual property. This compares to a net income of \$1.3 million, or \$0.04 per diluted share for fiscal 2009, which includes \$0.4 million or \$0.01 per share of legal expenses to protect intellectual property. Earnings per share (“EPS”) for fiscal 2010 and 2009 included amortization expense related to intangibles of \$2.8 million or \$0.09 per share and \$0.7 million or \$0.02 per diluted share, respectively. We generated adjusted EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization plus current year’s stock compensation expense, legal costs to enforce intellectual property rights, restructuring expenses related to acquisition, and charge for change in revenue recognition) of \$19.5 million in fiscal 2010 compared to \$13.5 million in fiscal 2009. Adjusted EBITDA is presented because such measure is used by rating agencies, securities analysis, investors and other parties in evaluating the Company. It should not be considered, however, as an alternative to operating income as an indicator of the Company’s operating performance or as an alternative cash flows as measures of the Company’s overall liquidity as presented in the Company’s consolidated financial statements. Further, Adjusted EBITDA measure shown for the Company may not be comparable to similarly titled measures used by other companies.

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

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

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

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

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

	Thirteen Weeks Ended January 2, 2010	Thirteen Weeks Ended January 1, 2011	Fifty-Two Weeks Ended January 2, 2010	Fifty-Two Weeks Ended January 1, 2011
Consolidated				
Net income (loss)	\$ 586	\$ (2,896)	\$ 1,317	\$ (13,926)
Interest (income) expense, net	(17)	240	(189)	371
Income tax provision	687	64	3,123	12,218
Amortization of intangibles	81	1,640	661	2,804
Depreciation and amortization	1,455	2,982	4,910	9,466
EBITDA	<u>2,792</u>	<u>2,030</u>	<u>9,822</u>	<u>10,933</u>
Share-based compensation	569	630	3,270	2,742
Legal costs to enforce intellectual property rights	299	87	433	2,284
Charge for change in revenue recognition	—	—	—	411
Add back legal restructuring	—	38	—	393
Add back other restructuring	—	1,496	—	2,731
Adjusted EBITDA	<u>\$ 3,590</u>	<u>\$ 4,281</u>	<u>\$ 13,525</u>	<u>\$ 19,494</u>

[Table of Contents](#)

	Thirteen Weeks Ended January 2, 2010	Thirteen Weeks Ended January 1, 2011	Fifty-Two Weeks Ended January 2, 2010	Fifty-Two Weeks Ended January 1, 2011
USAP excluding WAG				
Net income (loss)	\$ 586	\$ 218	\$ 1,317	\$ (7,909)
Interest (income) expense, net	(17)	295	(189)	378
Income tax provision	687	29	3,123	12,182
Amortization of intangibles	81	125	661	494
Depreciation and amortization	1,455	2,325	4,910	8,458
EBITDA	2,792	2,992	9,822	13,603
Share-based compensation	569	630	3,270	2,742
Legal costs to enforce intellectual property rights	229	87	433	2,284
Charge for change in revenue recognition	—	—	—	411
Adjusted EBITDA	\$ 3,590	\$ 3,709	\$ 13,525	\$ 19,040

Basis of Presentation

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

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

General and Administrative Expense. General and administrative expense consists primarily of administrative payroll and related expenses, payment processing fees, legal and professional fees, amortization of software and other administrative costs. General and administrative expense also includes depreciation and amortization expense directly related to sales.

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

Fulfillment Expense. Fulfillment expense consists primarily of payroll and related costs associated with our warehouse employees and our purchasing group, facility rent, building maintenance, depreciation and other costs associated with inventory management and our wholesale operations. Fulfillment expense also includes depreciation and amortization expense directly related to sales.

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

Amortization of Intangibles and impairment loss. Amortization of intangibles consists primarily of the amortization expense associated with certain intangibles recorded as a result of the Partsbin and WAG acquisitions. Impairment loss on intangibles consists primarily of the impairment loss associated with certain intangibles recorded as a result of the Partsbin acquisition.

Table of Contents

Goodwill impairment loss. Goodwill impairment loss consists of the non-cash impairment loss recorded as a result of the Partsbin acquisition.

Interest Income (Expense). Interest income consists primarily of interest income on investments. Interest expense consists primarily of interest expense on our outstanding loan balances and capital leases.

Other Income. Other income consists of miscellaneous income such as gain from disposition of assets.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, net sales, costs and expenses, as well as the disclosure of contingent assets and liabilities and other related disclosures. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, intangible and other long-lived assets and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of our assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates, and we include any revisions to our estimates in our results for the period in which the actual amounts become known.

We believe the critical accounting policies described below affect the more significant judgments and estimates used in the preparation of our consolidated financial statements. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our historical consolidated financial condition and results of operations:

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

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

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

Revenue from sales of advertising is recorded when performance requirements of the related advertising program agreement are met. For fiscal 2010, the advertising revenue represented 1% of our total revenue.

We evaluated the criteria of ASC Topic 605-45 - *Revenue Recognition - Principal Agent Considerations* (“ASC 605-45”), in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. When we are the primary party obligated in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers or have several but not all of these indicators, revenue is recorded gross.

Product sales and shipping revenues, net of promotional discounts and return allowances, are recorded when the products are delivered and title passes to customers. Retail items sold to customers are made pursuant to terms and conditions that provide for transfer of both title and risk of loss upon our delivery to the customer. Return allowances, which reduce product revenue by our best estimate of expected product returns, are estimated using historical experience. We generally require payment by credit card at the point of sale. Amounts received prior to when we deliver goods to customers are recorded as deferred revenue.

We periodically provide incentive offers to our customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off of current purchases and other similar offers. Current discount offers, when accepted by our customers, are treated as a reduction to the purchase price of the related transaction. Current discount offers and inducement offers are classified as an offsetting amount in net sales.

Table of Contents

Fair Value Measurements. During the first quarter of fiscal 2009, the Company adopted ASC Topic 820- *Fair Value Measurements and Disclosures* (“ASC 820”), which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. Additionally, in January 2010, the Company adopted Accounting Standards Update (“ASU”) 2010-6 - *Improving Disclosures About Fair Value Measurements* (“ASU 2010-6”), which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. We have adopted the provisions of ASC 820 as of January 1, 2008 for financial assets. ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1-defined as observable inputs such as quoted prices in active markets; Level 2-defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3-defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

We have evaluated both Level 2 and Level 3 evidence to measure the fair value of our \$4.2 million (par value) of auction rate preferred securities (“ARPS”) as of January 1, 2011. These investments consist solely of collateralized debt obligations supported by municipal and state agencies; do not include mortgage-backed securities or student loans; have redemption features that call for redemption at 100% of par value; and have a current credit rating of A or AAA. During fiscal 2010, we received partial redemptions at par on our investments totaling \$0.1 million. The fact that there is not an active market as of January 1, 2011 to liquidate 100% of these certain investments was the final determination in classifying them as Level 3. We used a discounted cash flow valuation model to estimate the fair value of the securities. As a result of the temporary declines in fair value of our ARPS, which we attribute to liquidity issues rather than credit issues, we have recorded an unrealized loss of \$0.1 million to accumulated other comprehensive income (loss). If our key assumptions used to determine estimated discounted cash flows change in the future, we may be required to record additional losses.

Inventory. Inventory consists of finished goods available-for-sale. We purchase inventory from suppliers both domestically and internationally, primarily in Taiwan and China. We believe that our products are generally available from more than one supplier, and we maintain multiple sources for many of our products, both internationally and domestically. We offer a broad line of auto parts for automobiles from model years 1965 to 2010. Because of the continued demand for our products, we primarily purchase products in bulk quantities to take advantage of quantity discounts and to ensure inventory availability.

Inventory is accounted for using the first-in first-out (“FIFO”) method and valued at the lower of cost or market value. During this valuation, we are required to make judgments about expected disposition of inventory, generally, through sales, returns to product vendors, or liquidations of obsolete or scrap products, and expected recoverable values of each disposition category based on currently-available information. If actual market conditions are less favorable than those anticipated by management, additional write-off of the value of our inventory may be required.

Website and Software Development Costs. We capitalize certain costs associated with software developed for internal use according to ASC Topic 350-40 - *Intangibles – Goodwill and Other – Internal-Use Software* (“ASC 350-40”), and ASC Topic 350-50- *Intangibles – Goodwill and Other – Website Development Costs* (“ASC 350-50”). Under these provisions, we capitalize costs associated with website development and software developed for internal use 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 development 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 these costs ceases when the project is substantially complete and ready for its intended use.

Long-Lived Assets and Intangibles. We acquire tangible and intangible assets in the normal course of business. We evaluate the recoverability of the carrying amount of these long-lived assets whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable in accordance with ASC Topic 360- *Property, Plant, and Equipment* (“ASC 360”). An impairment loss is recognized when the carrying value exceeds the undiscounted cash flows estimated to result from the use and eventual disposition of the asset. Impairment losses are recognized in operating earnings. We continually use judgment when applying these impairment rules to determine the timing of the impairment tests, undiscounted cash flows used to assess impairments, and the fair value of a potentially impaired asset. The reasonableness of our judgments could significantly affect the carrying value of our long-lived assets. During 2008, we recorded a non-cash impairment charge on long-lived assets totaling \$18.4 million as further described in “*Note 6- Goodwill and Intangibles*” of the Notes to Consolidated Financial Statements included in Part IV, Item 15 of this report. We did not recognize any impairment losses for fiscal 2009 and 2010.

Table of Contents

Goodwill and Indefinite-Lived Intangibles. We account for goodwill under the guidance set forth in ASC Topic 350- *Intangibles – Goodwill and Other* (“ASC 350”), which specifies that goodwill and indefinite-lived intangibles should not be amortized. We evaluate goodwill and indefinite-lived intangibles for impairment on an annual basis or more frequently if events or circumstances occur that would indicate a reduction in fair value. Our annual impairment testing date is October 31. In addition, we identified a single reporting unit in accordance with ASC 350. The goodwill impairment test is a two-step impairment test. The first step compares the fair value of each reporting unit with its carrying amount including goodwill. We estimate the fair value of the reporting unit based on an equal weighting of two market approaches and an income approach, which utilizes discounted future cash flows. The market approaches utilized market multiples of invested capital from 1) comparable publicly traded companies and 2) comparable transactions. The market multiples from invested capital include revenues, total assets, book equity plus debt and earnings before interest, taxes, depreciation and amortization (“EBITDA”). Assumptions critical to the fair value estimates under the discounted cash flow model include discount rates, cash flow projections, projected long-term growth rates and the determination of terminal values. Management has performed a sensitivity analysis on its significant assumptions and has determined that a change in its assumptions within selected sensitivity testing levels would not impact its conclusion. The excess of fair value over carrying value for our reporting unit as of October 31, 2010, the annual testing date, was approximately \$187 million, and there would have to be a 65% decrease in the fair value of the reporting unit to fail step 1. If the carrying amount exceeds fair value, then the second step of the impairment test is performed to measure the amount of any impairment loss by comparing the implied fair value of the reporting unit to its carrying value. We completed our annual testing and passed the first step of the impairment test. We did not recognize any impairment loss on goodwill and indefinite-lived intangibles for fiscal 2009 and 2010. During 2008, we recorded a non-cash impairment charge on goodwill totaling \$4.4 million, due to the significant decline in the Company’s stock price to a level indicating a market capitalization below book value during the fourth quarter ended December 31, 2008. We also recorded a \$0.7 million impairment loss on indefinite-lived intangible assets during calendar year 2008 as further described in “*Note 6- Goodwill and Intangibles*” of the Notes to Consolidated Financial Statements included in Part IV, Item 15 of this report.

Income Taxes. The Company accounts for income taxes in accordance with ASC Topic 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 reserve 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. The ability to realize deferred tax assets depends on the ability to generate sufficient taxable income within the carryback or carryforward periods provided for in the tax law for each applicable tax jurisdiction. We consider the following possible sources of taxable income when assessing the realization of our deferred tax assets:

- Future reversals of existing taxable temporary differences;
- Future taxable income exclusive of reversing temporary differences and carry-forwards;
- Taxable income in prior carry-back years; and
- Tax-planning strategies.

The assessment regarding whether a valuation allowance is required or should be adjusted also considers, among other matters, the nature, frequency and severity of recent losses of the combined USAP and WAG operations, forecasts of future profitability, the duration of statutory carryforward periods, our experience with tax attributes expiring unused and tax planning alternatives. In making such judgments, significant weight is given to evidence that can be objectively verified.

Concluding that a valuation allowance is not required is difficult when there is significant negative evidence that is objective and verifiable, such as cumulative losses in recent years. Although we expect that the operations of the recently acquired WAG business and our ability to achieve future profitability of these operations was enhanced by the cost reductions that occurred as a result of the acquisition and subsequent integration efforts, WAG’s historic operating results remain relevant as they are reflective of the industry and the effect of economic conditions. The fundamental businesses and inherent risks in which the WAG business operates did not change from those which existed prior to the acquisition. We utilized a three-year analysis of actual results as the primary measure of cumulative losses in recent years. However, because a substantial portion of those cumulative losses relate to impairment of intangible assets and goodwill, those three-year cumulative results are adjusted for the effect of these items. In addition, the near- and medium-term financial outlook is considered when assessing the need for a valuation allowance.

The valuation of deferred tax assets requires judgment and assessment of the future tax consequences of events that have been recorded in the financial statements or in the tax returns, and our future profitability represents our best estimate of those future events. Changes in our current estimates, due to unanticipated events or otherwise, could have a material effect

Table of Contents

on our financial condition and results of operations. Prior to the acquisition of WAG, the Company concluded that it was more likely than not that we would realize the deferred tax assets in all jurisdictions. However, with the acquisition of WAG, based largely on the weight of the combined cumulative three-year adjusted loss position, it was determined that it was not more likely than not that the Company would realize its net deferred tax assets as of January 2, 2011. Therefore, a valuation allowance of \$18.3 million was recorded as of January 1, 2011, of which \$4.7 million was recorded in relation to WAG upon our acquisition as of August 12, 2010

If, in the future, we generate taxable income on a sustained basis in jurisdictions where we have recorded full valuation allowances, our conclusion regarding the need for full valuation allowances in these tax jurisdictions could change, resulting in the reversal of some or all of the valuation allowances. If our operations generate taxable income prior to reaching profitability on a sustained basis, we would reverse a portion of the valuation allowance related to the corresponding realized tax benefit for that period, without changing our conclusions on the need for a full valuation allowance against the remaining net deferred tax assets.

At January 1, 2011, federal and state net operating loss (NOL) carryforwards were \$6.8 million and \$27.5 million, respectively. Federal NOL carryforwards of \$2.7 million were acquired in the acquisition of WAG which are subject to Internal Revenue Code section 382 and limited to an annual usage limitation of \$135,000. Additionally the tax benefit of \$0.9 million of the federal and state NOL carryforwards which were created by the exercise of stock options will be credited to additional paid in capital once recognized. Federal NOL carryforwards expire in 2029 and 2030, while state NOL carryforwards begin to expire in 2016. The state NOL carryforwards expire in the respective tax years as follows (in thousands):

2016 - 2022	\$24,916
2023 - 2030	<u>2,553</u>
	<u>\$27,469</u>

The Company utilizes a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. As of January 1, 2011, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. The Company's policy is to record interest and penalties as income tax expense.

The Company is subject to U.S. federal income tax as well as income tax of foreign and state tax jurisdictions. During calendar year 2008, the Company was audited by the Internal Revenue Service for the years ended December 31, 2006 and 2007. The audit was concluded with the payment of a non-material sum. During fiscal 2010, the Company was audited by the Internal Revenue Service for the year ended December 31, 2008. The audit was concluded with no change. The tax years 2006-2009 remain open to examination by the major taxing jurisdictions to which the Company is subject.

Share-Based Compensation. The Company accounts for share-based compensation in accordance with ASC Topic 718-*Compensation – Stock Compensation* ("ASC 718"). ASC 718 requires that all share-based compensation to employees, including grants of employee stock options, be recognized in our financial statements based on their respective grant date fair values. 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. We currently use the Black-Scholes option pricing model to estimate the fair value of our share-based payment awards, with the exception of options granted containing market conditions, for which we estimate the fair value using a Monte Carlo model. The Black-Scholes and Monte Carlo valuation models require extensive use of accounting judgment and financial estimates, including estimates of the expected term participants will retain their vested stock options before exercising them, the estimated volatility of our common stock price over the expected term and the number of options that will be forfeited prior to the completion of their vesting requirements. Application of alternative assumptions could produce significantly different estimates of the fair value of share-based compensation and, consequently, the related amount of share-based compensation expense recognized in the Consolidated Statement of Operations could have been significantly different than the amounts recorded. We estimate volatility using historical volatilities of similar public entities. The expected life of the awards is based on a simplified method that defines the life as the average of the contractual term of the options and the weighted average vesting period for all open tranches. Prior to our initial public offering in February 2007, we did not have a history of market prices of our common stock. Due to the limited period time our equity shares have been publicly traded, we do not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The risk-free interest rate assumption is based on observed interest rates appropriate for the expected life of our awards. The dividend yield assumption is based on our history and expectation of paying no dividends.

Table of Contents

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We consider many factors when estimating expected forfeitures, including employee class, economic environment, and historical experience. Share-based compensation expense recognized in our financial statements is based on awards that are ultimately expected to vest. If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested options, we may be required to accelerate, increase or cancel any remaining unrecognized share-based compensation expense.

Valuation at the Time of Grant. We have granted to our employees options to purchase common stock at exercise prices equal to the fair market value of the underlying common stock at the time of each grant, which is the closing market price of our common stock.

Under provisions of ASC 718, we recognized \$2.9 million, \$3.3 million and \$2.7 million of share-based compensation expense for calendar year 2008, fiscal 2009 and fiscal 2010, respectively. At January 1, 2011, the total compensation cost related to unvested stock-based awards granted to employees and non-employee directors under our equity incentive plans but not yet recognized was approximately \$3.3 million, net of estimated forfeitures of approximately \$2.0 million. This cost will be amortized over a weighted-average period of approximately 2.11 years and will be adjusted for subsequent changes in estimated forfeitures.

Recent Accounting Pronouncements

Effective July 1, 2009, the Company adopted the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 105- *Generally Accepted Accounting Principles* (“ASC 105”), which establishes the FASB ASC as the single source of authoritative U.S. generally accepted accounting principles (“GAAP”) used by nongovernmental entities in the preparation of financial statements, except for rules and interpretive releases of the SEC under authority of federal securities laws, which are sources of authoritative accounting guidance for SEC registrants.

In October 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2009-13, *Revenue Arrangements with Multiple Deliverables*, which amends Accounting Standards Codification (“ASC”) Topic 605, which modifies the accounting for multiple deliverable revenue arrangements to enable vendors to account for deliverables separately rather than as a combined unit. The adoption will not have a material effect on the consolidated financial statements.

In January 2010, the FASB issued ASU 2010-6, *Improving Disclosures About Fair Value Measurements*, which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. ASU 2010-6 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. The adoption of ASU 2010-6 did not have a material effect on the consolidated financial statements.

[Table of Contents](#)

Results of Operations

The following table sets forth selected statement of operations data for the periods indicated, expressed as a percentage of net sales:

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
Net sales	100.0%	100.0%	100.0%
Cost of sales	65.7	63.8	65.8
Gross profit	34.3	36.2	34.2
Operating expenses:			
General and administrative	11.9	11.1	10.9
Marketing	15.0	13.3	14.8
Fulfillment	5.9	6.5	5.7
Technology	2.4	2.5	2.3
Amortization of intangibles and impairment loss	15.6	0.4	1.1
Impairment loss on goodwill	2.9	—	—
Total operating expenses	53.7	33.8	34.7
(Loss) income from operations	(19.4)	2.4	(0.5)
Other income (expense):			
Other income	—	—	—
Interest income (expense), net	0.6	0.1	(0.1)
Other income (expense), net	0.6	0.1	(0.1)
(Loss) income before income taxes	(18.8)	2.5	(0.7)
Income tax (benefit) provision	(7.8)	1.8	4.7
Net (loss) income	(11.0)%	0.7%	(5.3)%

The impact of foreign currency is related to our offshore operations in the Philippines and sales of our products in Canada and was not material to our operations.

Fifty-Two Weeks Ended January 2, 2010 Compared to the Fifty-Two Weeks Ended January 1, 2011

Net Sales and Gross Margin

	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011	\$ Change	% Change
	(in thousands)			
Net sales	\$176,288	\$262,277	\$85,989	48.8%
Cost of sales	112,415	172,668	60,253	53.6%
Gross profit	\$ 63,873	\$ 89,609	\$25,736	40.3%
Gross margin	36.2%	34.2%		(2.0)%

Net sales increased \$86.0 million, or 48.8%, for fiscal 2010 compared to fiscal 2009. Excluding \$39.1 million of sales from WAG, the net sales for fiscal 2010 were \$223.2 million, an increase of 26.6% over fiscal 2009 net sales due to increases of \$42.5 million, or 25.9%, in online sales and \$4.4 million, or 36%, in offline sales, which consist of our Kool-View™ and wholesale operations. Our online sales consist of our e-commerce, online marketplace sales channels and online advertising. Our e-commerce channel includes our e-commerce websites supported by our call-center sales agents who generate cross-sell and up-sell opportunities. Our online marketplaces consist primarily of auction and other third-party websites. Online advertising is sold on our e-commerce websites.

The increase in online sales resulted from an increase of 355,130, or 24.8%, in total placed orders, an increase of 8.0 million, or 7.6%, in unique visitors, partially offset by a decrease of \$8.24, or 1.7%, in average order value from fiscal 2009 to fiscal 2010. The increases in total placed orders and the unique visitors resulted from increased marketing spend driving higher paid traffic and better content on our websites driving more organic traffic. The increases were also attributed to more effective pricing, better catalog data and a better customer experience. Our average order value declined due to increased pricing competition and increased sales of lower cost direct sourced products. We expect our sales to increase in the coming year in line with our continuous effort to improve our content on our websites and customer experience.

[Table of Contents](#)

Gross profit increased 40.3% from fiscal 2009 to fiscal 2010. Excluding the acquisition of WAG, gross profit was \$75.8 million, an increase of 18.6%. Gross margin declined 2.0% to 34.2% of net sales compared with fiscal 2009. Excluding the acquisition of WAG, gross margin was 34.0% for fiscal 2010. Gross margin was unfavorably impacted by increased freight expense and a discontinuation of high margin loyalty programs in fiscal 2010. We expect gross margin to increase in the coming year and eventually increase above 34% from new pricing initiatives.

General and Administrative Expense

	<u>52 Weeks Ended January 2, 2010</u>	<u>52 Weeks Ended January 1, 2011</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
General and administrative expense	\$ 19,640	\$ 28,628	\$ 8,988	45.8%
Percent of net sales	11.1%	10.9%		(0.2)%

General and administrative expense increased \$9.0 million or 45.8% for fiscal 2010 compared to fiscal 2009. Excluding \$5.9 million from WAG, the general and administrative expense increased primarily due to the acquisition and integration costs of \$1.4 million related to our acquisition of WAG.

Marketing Expense

	<u>52 Weeks Ended January 2, 2010</u>	<u>52 Weeks Ended January 1, 2011</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Marketing expense	\$ 23,419	\$ 38,757	\$ 15,338	65.8%
Percent of net sales	13.3%	14.8%		1.5%

Marketing expense increased \$15.3 million, or 65.8%, for fiscal 2010 compared to fiscal 2009. Excluding \$8.6 million of marketing expense from WAG, the marketing expense increased \$6.7 million or 2.9% from fiscal 2009, primarily due to higher amortization costs related to software deployments and an increase in marketing spend which resulted in higher listing and placement fees paid to commercial and search engine websites such as eBay, Google and MSN. We expect no significant fluctuation in our marketing expense in the coming year.

Fulfillment Expense

	<u>52 Weeks Ended January 2, 2010</u>	<u>52 Weeks Ended January 1, 2011</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Fulfillment expense	\$ 11,437	\$ 14,946	\$ 3,509	31.1%
Percent of net sales	6.5%	5.7%		(0.8)%

Fulfillment expense increased \$3.5 million, or 31.1%, for fiscal 2010 compared to fiscal 2009. Excluding \$1.7 million of fulfillment expense from WAG, the fulfillment expense increased \$1.8 million due to an increase in external labor, partially offset by the fixed cost leverage from higher sales during fiscal 2010. The increase in external labor is due to higher need of workforce at our distribution centers in fiscal 2010 in line with the increase in our inventory. We expect our fulfillment expense to remain consistent in the coming year.

[Table of Contents](#)

Technology Expense

	<u>52 Weeks Ended</u> <u>January 2,</u> <u>2010</u>	<u>52 Weeks Ended</u> <u>January 1,</u> <u>2011</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Technology expense	\$ 4,467	\$ 5,902	\$ 1,435	32.3%
Percent of net sales	2.5%	2.3%		(0.2)%

Technology expense increased \$1.4 million, or 32.3% for fiscal 2010 compared to fiscal 2009. Excluding \$1.3 million of technology expense from WAG, the technology expense for fiscal 2010 remained consistent from fiscal 2009. We expect no significant fluctuation in technology expense in the coming year.

Amortization of Intangibles and Impairment Loss

	<u>52 Weeks Ended</u> <u>January 2,</u> <u>2010</u>	<u>52 Weeks Ended</u> <u>January 1,</u> <u>2011</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Amortization of intangibles and impairment loss	\$ 661	\$ 2,804	\$ 2,143	324.2%
Percent of net sales	0.4%	1.1%		0.7%

Amortization of intangibles and impairment loss increased by \$2.1 million, or 324.2%, in fiscal 2010, primarily due to the amortization expense of \$2.3 million related to the intangible assets acquired in connection with our acquisition of WAG in August 2010.

Other Income (Expense), Net

	<u>52 Weeks Ended</u> <u>January 2,</u> <u>2010</u>	<u>52 Weeks Ended</u> <u>January 1,</u> <u>2011</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Other income (expense), net	\$ 191	\$ (280)	\$ (471)	(246.6)%
Percent of net sales	0.1%	(0.1)%		(0.2)%

Other income, net decreased \$0.5 million, or 246.6% for fiscal 2010 compared to fiscal 2009, primarily due to the interest of \$0.4 million paid in connection with the Company's credit facility executed in August 2010.

Income Tax Provision (Benefit)

	<u>52 Weeks Ended</u> <u>January 2,</u> <u>2010</u>	<u>52 Weeks Ended</u> <u>January 1,</u> <u>2011</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Income tax provision (benefit)	\$ 3,123	\$ 12,218	\$ 9,095	291.2%
Percent of net sales	1.8%	4.7%		2.9%

For fiscal 2010 and 2009, the effective tax rate for the Company was (715.3)% and 70.33%, respectively. The Company's effective tax rate is significantly higher in fiscal 2010 than the U.S. federal statutory rate primarily due to the recognition of a valuation allowance of \$13.6 million. Prior to the acquisition of WAG, the Company concluded that it was more likely than not that we would realize the deferred tax assets in all jurisdictions. However, with the acquisition of WAG, based largely on the weight of the combined cumulative three-year adjusted loss position, it was determined that it was not more likely than not that the Company would realize its net deferred tax assets. Therefore, a valuation allowance of \$18.3 million was recorded as of January 1, 2011, of which \$4.7 million was recorded against the acquired deferred tax assets of WAG as of August 12, 2010.

Table of Contents

The components of income (loss) before income taxes consist of the following:

	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
Domestic operations	\$ 3,795	\$ (2,540)
Foreign operations	645	832
Total income (loss) before income taxes	<u>4,440</u>	<u>(1,708)</u>

Income tax (benefit) expense differs from the amount that would result from applying the federal statutory rate as follows:

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
		(in thousands)	
Income tax at U.S. federal statutory rate	\$ (9,768)	\$ 1,511	\$ (581)
Share-based compensation	161	1,086	(93)
State income tax, net of federal tax effect	(1,880)	729	(759)
Tax exempt interest	(220)	(16)	(8)
Foreign tax	60	(163)	(210)
Non deductible acquisition costs	—	—	258
Other	(175)	(24)	1
Change in valuation allowance	—	—	13,610
Effective tax (benefit) provision	<u>\$ (11,822)</u>	<u>\$ 3,123</u>	<u>\$ 12,218</u>

The Company's effective tax rate was impacted by income taxes incurred in foreign and state jurisdictions. With respect to the income of its foreign subsidiaries, the Company takes the position that the earnings of the foreign subsidiaries are permanently invested in that jurisdiction. As a result, no additional income taxes have been provided on the possible repatriation of these earnings to the parent company. The Company has not calculated the amount of deferred tax liability that would result from such repatriation as such determination is not practicable.

The favorable impact of foreign taxes is due in large part to a tax holiday in the Philippines, which is effective through September 2011. The term of the tax holiday is four years, provided as an incentive for new business and no further requirements exist to maintain the tax holiday. The impact of this tax holiday decreased foreign taxes by \$0, \$136,000 and \$182,000 for calendar year 2008, fiscal 2009 and fiscal 2010, respectively. The benefit of the tax holiday on net income per share (diluted) was immaterial for the related years.

As of January 1, 2011, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters.

Year Ended December 31, 2008 Compared to the Fifty-Two Weeks Ended January 2, 2010

Net Sales and Gross Margin

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	\$ Change	% Change
		(in thousands)		
Net sales	\$ 153,424	\$ 176,288	\$22,864	14.9%
Cost of sales	100,869	112,415	11,546	11.4%
Gross profit	\$ 52,555	\$ 63,873	\$11,318	21.5%
Gross margin	34.3%	36.2%		1.9%

Table of Contents

Net sales increased \$22.9 million, or 14.9%, for fiscal 2009 compared to calendar year 2008. This increase was mainly attributable to an increase in our online sales of \$23.6 million, or 16.8%, offset in part by a decrease of \$0.8 million, or 5.9%, in our offline business, which consists of our Kool-Vue™ and wholesale operations. Our online business consists of our e-commerce and online marketplace sales channels and includes online advertising. Our e-commerce channel includes our e-commerce websites supported by our call-center sales agents who generate cross-sell and up-sell opportunities. Our online marketplaces consist primarily of auction and other third-party websites. Online advertising is sold on our e-commerce websites.

E-commerce sales increased \$22.9 million, or 19.5%, to \$140.1 million for fiscal 2009 compared to \$117.2 million for calendar year 2008. The increase is primarily due to increased traffic of 9.5 million or 9.9% to 106.1 million unique visitors and a 10 basis point increase in conversion rate to 1.35% for fiscal 2009 compared to 96.6 million unique visitors and a conversion rate of 1.25% for calendar year 2008. The increase in unique visitors primarily resulted from increased marketing spend driving higher paid traffic and better content on our websites driving more organic traffic. The increase in conversion was largely due to more effective pricing, better catalog data and a better customer experience. Total e-commerce orders increased by 222,000 or 18.3% to 1.4 million orders for fiscal 2009. Our average order value declined to \$119 for fiscal 2009 compared with \$124 for calendar year 2008 which was primarily attributable to increased pricing competition and increased sales of lower cost direct sourced products.

Online marketplace sales decreased \$0.5 million, or 2.2%, to \$20.5 million for fiscal 2009 compared to \$21.0 million for calendar year 2008 due in part to a decline in marketplace traffic.

Net sales from our offline business declined by \$0.8 million, or 5.9%, to \$12.3 million for fiscal 2009 from calendar year 2008. The decrease in net sales was the result of reduced purchases from a significant customer in fiscal 2009.

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

Gross profit was \$63.9 million, or 36.2% of net sales, for fiscal 2009, compared to \$52.6 million, or 34.3% of net sales, in the prior year. The 1.9% increase in gross margin for fiscal 2009 compared to the prior year was primarily due to lower outbound freight expense, lower product costs, purchase discounts, and increased revenue from sales of advertising on our websites.

General and Administrative Expense

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
General and administrative expense	\$ 18,234	\$ 19,640	\$ 1,406	7.7%
Percent of net sales	11.9%	11.1%		(0.8)%

General and administrative expense increased \$1.4 million or 7.7% for fiscal 2009 compared to calendar year 2008 primarily due to an increase in bonuses and share-based compensation for our employees, increased merchant fees due to a higher sales volume, increased legal fees related to the litigation to protect our intellectual property, and increased depreciation and amortization expense for internally-developed software that was placed into production in fiscal 2009; partially offset by lower professional fees and labor expense.

During fiscal 2009, share-based compensation expense increased by \$0.4 million primarily due to performance-based option awards.

[Table of Contents](#)

Marketing Expense

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended</u> <u>January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Marketing expense	\$ 22,965	\$ 23,419	\$ 454	2.0%
Percent of net sales	15.0%	13.3%		(1.7)%

Marketing expense increased \$0.5 million, or 2.0%, for fiscal 2009 compared to calendar year 2008. As a percentage of net sales, marketing expense decreased 1.7% to 13.3% for fiscal 2009 compared to the prior-year primarily due to reduced personnel costs, partially offset by higher e-commerce advertising spending from increased unique visitors. Marketing spend as a percentage of sales was 7.1% for fiscal 2009 compared to 7.3% in the prior year. Reduced spend in our online marketplaces sales channel also contributed to this percentage decrease for fiscal 2009.

Fulfillment Expense

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended</u> <u>January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Fulfillment expense	\$ 9,116	\$ 11,437	\$ 2,321	25.5%
Percent of net sales	5.9%	6.5%		0.6%

Fulfillment expense increased \$2.3 million, or 25.5%, for fiscal 2009 compared to the prior year. As a percentage of net sales, fulfillment expense increased 0.6% to 6.5% for fiscal 2009 primarily due to expenses related to our new distribution center in Virginia that opened in 2009.

Technology Expense

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended</u> <u>January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Technology expense	\$ 3,642	\$ 4,467	\$ 825	22.7%
Percent of net sales	2.4%	2.5%		0.1%

Technology expense increased \$0.8 million, or 22.7% for fiscal 2009 compared to the prior year. As a percentage of sales, technology expense increased 0.1% to 2.5% mainly due to higher personnel related expenses and increased communication bandwidth to support our growing infrastructure and investments in our overall technology platform.

Amortization of Intangibles and Impairment Loss

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended</u> <u>January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Amortization of intangibles and impairment loss	\$ 23,896	\$ 661	\$(23,235)	(97.2)%
Percent of net sales	15.6%	0.4%		(18.1)%

Amortization of intangibles and impairment loss declined by \$23.2 million, or 97.2%, in fiscal 2009. Calendar year 2008 included non-cash impairment of \$18.3 million on intangible assets. For further discussion refer to "Note -6 Goodwill and Intangibles" of the Notes to Consolidated Financial Statements included in Part IV, Item 15 of this report. We estimate aggregate amortization expense related to these intangibles for the years 2010, 2011, 2012, 2013 and 2014 to be approximately \$323,000, \$323,000, \$323,000, \$288,000 and \$112,000, respectively.

[Table of Contents](#)

Impairment Loss on Goodwill

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended</u> <u>January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Impairment loss on Goodwill	\$ 4,430	\$ —	\$(4,430)	(100)%
Percent of net sales	2.9%	0.0%		(2.9)%

There was no impairment on goodwill in fiscal 2009. Calendar year 2008 included non-cash impairment of \$4.4 million on goodwill. For further discussion refer to “*Note -6 Goodwill and Intangibles*” of the Notes to Consolidated Financial Statements included in Part IV, Item 15 of this report.

Other Income (Expense), Net

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended</u> <u>January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Other income (expense), net	\$ 1,000	\$ 191	\$ (809)	(80.9)%
Percent of net sales	0.7%	0.1%		(0.6) %

Other income, net decreased \$0.8 million, or 80.9% for fiscal 2009 compared to the prior year, resulting from lower interest income from a decline in interest rates during fiscal 2009 compared to calendar year 2008.

Income Tax Provision (Benefit)

	<u>Year Ended</u> <u>December 31,</u> <u>2008</u>	<u>52 Weeks</u> <u>Ended</u> <u>January 2,</u> <u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(in thousands)			
Income tax provision (benefit)	\$ (11,822)	\$ 3,123	\$14,945	126.4%
Percent of net sales	(7.7)%	1.8%		9.5 %

For fiscal 2009 and 2008, the effective tax rate for the Company was 70.33% and 41.36%, respectively. The Company’s effective tax rate is higher than the U.S. federal statutory rate primarily as a result of state income taxes and other non-deductible permanent differences. The increase in income tax provision during fiscal 2009 was primarily due to a \$1.1 million tax effect of stock option forfeitures and other non-deductible permanent differences. The decrease in income tax provision (benefit) during calendar year 2008 was primarily due to the tax effect of the \$4.5 million and \$23.4 million impairment losses on our goodwill and intangible assets, respectively.

[Table of Contents](#)

Liquidity and Capital Resources

Sources of Liquidity

In fiscal 2010, we funded our operations with cash and cash equivalents generated from operations in prior years, sale of marketable securities, credit facilities and capital lease financings. We had no balance outstanding under our bank line of credit during fiscal 2010.

Cash Flows

The following table summarizes the key cash flow metrics from our consolidated statements of cash flow for calendar year 2008, fiscal 2009 and fiscal 2010, respectively, ended:

	<u>December 31,</u> <u>2008</u>	<u>January 2,</u> <u>2010</u>	<u>January 1,</u> <u>2011</u>
	<i>(in thousands)</i>		
Net cash provided by (used in) operating activities	2,996	11,587	(1,709)
Net cash provided by (used in) investing activities	11,178	(18,079)	(31,048)
Net cash (used in) provided by financing activities	(1,075)	115	23,883
Effect of exchange rate changes on cash	<u>(25)</u>	<u>155</u>	<u>218</u>
Net increase (decrease) in cash and cash equivalents	<u>13,074</u>	<u>(6,222)</u>	<u>(8,656)</u>

We had cash and cash equivalents of \$17.6 million as of January 1, 2011, representing a \$8.7 million decrease from \$26.3 million of liquid assets as of January 2, 2010. The decrease in our cash and cash equivalents as of January 1, 2011 was primarily due to our acquisition of WAG, purchase of inventory and investment in property and equipment, which was partially offset by cash generated from operations, sale of marketable securities and borrowings under our credit facility in fiscal 2010.

Operating Activities

Net cash provided by operating activities decreased by approximately \$13.3 million for fiscal 2010, as compared to fiscal 2009. The decrease was primarily due to an increase in purchase of inventory, which was offset by an improvement in timing of payments on accounts payable and net earnings in fiscal 2010 after adjusting for non-cash items such as depreciation and amortization and deferred income taxes. Net cash provided by operating activities increased by approximately \$8.6 million for fiscal 2009, as compared to calendar year 2008. The increase was primarily due to higher earnings after adjusting for non-cash items such as depreciation and amortization and deferred income taxes, which was partially offset by utilization of cash for purchase of inventory. The improvement in cash flows from operating activities in fiscal 2009 also reflected the timing of payments on accounts payable and collections on accounts receivables.

Investing Activities

Net cash used in investing activities increased by approximately \$13.0 million for fiscal 2010, as compared to fiscal 2009. The increase was primarily due to our acquisition of WAG and purchase of property and equipment, which was partially offset by proceeds from sale of short-term marketable securities. Net cash used in investing activities increased by approximately \$29.3 million for fiscal 2009, as compared to calendar year 2008, primarily due to higher purchase of short-term marketable securities and purchase of property and equipment.

Financing Activities

Net cash provided by financing activities increased by approximately \$23.8 million for fiscal 2010, as compared to fiscal 2009. The increase was primarily due to borrowings of \$25 million under our credit facility in fiscal 2010. Net cash provided by financing activities increased by approximately \$1.2 million for fiscal 2009, as compared to calendar year 2008, primarily due to a decrease in the payments made on borrowings.

Table of Contents

Funding Requirements

As of January 1, 2011, our working capital was of \$20.7 million. The historical seasonality in our business during the fourth and first calendar quarters of each year cause cash and cash equivalents, inventory and accounts payable to be generally higher in these quarters, resulting in fluctuations in our working capital.

In August 2010, the Company and Silicon Valley Bank (“Bank”) entered into a Loan and Security Agreement (the “Loan Agreement”) and other definitive documentation for a \$35 million secured credit facility (the “Facility”). The Facility is comprised of a term loan in the original principal amount of \$25 million and a revolving line of credit with availability up to \$10 million. The Facility has a final maturity date of June 30, 2014, and borrowings under the Facility bear interest, at the election of the Company, at LIBOR (with a floor of 1.25%) plus a margin of from 2.00% to 3.00% per annum, or at the Wall Street Journal Prime Rate plus a margin of from 1.00% to 2.00% per annum, based upon the Company’s maximum funded debt ratio. An unused revolving line fee of 0.375% per annum is payable on the undrawn committed amount of the revolving line of credit. Interest on outstanding borrowings under the term loan and the revolving line of credit is payable no less than quarterly, and the outstanding principal of the term loan amortized over four years and payable quarterly, with any outstanding amount under the Facility to be paid in full on the final maturity date. Borrowings under the Facility are secured by liens over all assets of the Company, including shares of stock in each of the Company’s subsidiaries. Ten of the Company’s subsidiaries are acting as co-borrowers under the Facility. At January 1, 2011, the LIBOR rate and the margin were 1.25% and 3.00% per annum, respectively. The Company had no borrowings on the revolving line of credit during fiscal 2010.

The Loan Agreement requires the Company to comply with a number of covenants, including financial covenants related to Maximum Funded Debt to Consolidated EBITDA, Liquidity, and Consolidated Fixed Charge Coverage Ratios; negative pledge requirements; requirements to deliver quarterly and annual consolidated financial statements; requirements to maintain adequate insurances; prohibitions on changes in the business and disposition of the Company’s assets; and other customary covenants. The Loan Agreement also requires the Company to obtain a prior written consent from the Bank when the Company determines to pay any dividends on or make any distribution related to our common stock. The Loan Agreement includes usual and customary events of default and remedies for facilities of this nature. On February 28, 2011, the Company and the Bank entered into Amendment No. 1 to Loan and Security Agreement and Limited Waiver (“Amendment”). The Amendment waived the Company’s lack of compliance with the Consolidated Fixed Charge Coverage Ratio Covenant in the Loan Agreement as of January 1, 2011. The Amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA to more readily accommodate the Company’s integration of the WAG acquisition.

We anticipate that funds generated from operations and cash on hand will be sufficient to meet our working capital needs, expected capital expenditures and the servicing of the debt for at least the next twelve months. Our future capital requirements may, however, vary materially from those now planned or anticipated. Changes in our operating plans, lower than anticipated net sales, additional acquisitions, increased expenses, continued or worsened economic conditions, or other events, including those described in “Risk Factors,” may cause us to seek debt or equity financings in the future. Financings may not be available on acceptable terms, on a timely basis, or at all, and our failure to raise adequate capital when needed could negatively impact our growth plans and our financial condition and results of operations. As of January 1, 2011, our \$4.1 million (fair value) of ARPS investments remain classified as long-term investments as a result of failed auctions and market liquidity issues. We may not have immediate access to those funds.

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

Debt and Available Borrowing Resources

Short-term debt and long-term debt increased by \$6.3 million and \$18.1 million, respectively, for fiscal 2010 as compared to fiscal 2009. The net increase is due to spending on the acquisition of WAG and executing capital leases in fiscal 2010. The Company had no borrowings in fiscal 2009, and the short-term debt of \$47,000 for calendar year 2008 was related to capital lease obligation that was paid off in fiscal 2009. There was no long-term debt in calendar year 2008.

Our debt-equity ratio is calculated as the carrying value of debt divided by the carrying value of equity. As of January 1, 2011, our debt-equity ratio was 0.33 due to borrowings under our new credit facility in fiscal 2010.

As of January 1, 2011, an unused revolving line of credit with availability up to \$10 million was available to the Company to obtain short-term and long-term financings if we need additional liquidity.

[Table of Contents](#)

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Contractual Obligations

The following table sets forth our contractual cash obligations and commercial commitments as of January 1, 2011.

Contractual Obligations:	Payment Due By Period (in thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Principal payments on long-term debt ⁽¹⁾	24,000	6,125	13,125	4,750	
Interest payments on long-term debt ⁽²⁾	2,040	908	1,051	81	
Operating lease obligations ⁽³⁾	6,004	1,482	2,883	1,260	379
Capital lease obligations ⁽⁴⁾	332	196	136		

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

⁽²⁾ Amounts represent the expected interest cash payments relating to our long-term debt. The interest rate at January 1, 2011 was used to calculate the expected future interest payments.

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

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

Seasonality

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

Inflation

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk. Our investment securities generally consist of high-grade auction rate preferred securities. As of January 1, 2011, our long-term investments included \$4.1 million (fair value) of investments in ARPS, which consist of high-grade (A or AAA rated) collateralized debt obligations issued by municipalities and state agencies. Our ARPS have an interest rate that is reset in short intervals through auctions. The current conditions in the global credit markets have prevented some investors from liquidating their holdings of ARPS because the amount of securities submitted for sale has exceeded the amount of purchase orders for these securities. If there is insufficient demand for the securities at the time of an auction, the auction may not be completed and the interest rates may be reset to predetermined higher rates. When auctions for these securities fail, the investments may not be readily convertible to cash until a future auction of these investments is successful or they are redeemed or mature. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other- than- temporary, we would be required to adjust the carrying value of the investment through an impairment charge.

On February 13, 2008, we were informed that there was insufficient demand at auctions for four of our high-grade ARPS, representing approximately \$7.8 million. As a result, these affected securities are currently not liquid and the interest rates have been reset to the predetermined higher rates. For the period June 30, 2008 through January 1, 2011, we have received partial redemptions at par on all four ARPS totaling \$3.5 million. The remaining principal balance on our ARPS is \$4.2 million as of January 1, 2011.

In the event we need to access the funds that are in an illiquid state, we will not be able to do so without the possible loss of principal until a future auction for these investments is successful or they are redeemed by the issuer. At this time, management has not obtained sufficient evidence to conclude that these investments are other-than-temporarily impaired or that they will not be settled in the short term, although the market for these investments is presently uncertain. If we are unable to sell these securities in the market or they are not redeemed, then we may be required to hold them indefinitely. We do not expect to have a need to access these funds for operational purposes for the foreseeable future. We plan to continue to monitor and evaluate these investments on an ongoing basis for impairment. Based on our ability to access our cash and other short-term investments, our expected cash flows, and our other sources of cash, we do not anticipate that the potential illiquidity of these investments will affect our ability to execute our current business plan. However, due to the illiquidity in the market, we have recorded \$0.1 million of unrealized losses on our investment portfolio as of January 1, 2011.

As of January 1, 2011, we had a balance of \$24.0 million outstanding under a term loan under our credit facility with Silicon Valley Bank. The interest rate on this loan is computed at a LIBOR loan rate, adjusted by features specified in our loan agreements. At our current debt level as of January 1, 2011, a 100 basis point increase in interest rates would not materially affect our earnings and cash flows. If, however, we are unable to meet the covenants in our loan agreement, we would be required to renegotiate the terms of credit under the loan agreement, including the interest rate. There can be no assurance that any renegotiated terms of credit would not materially impact our earnings. As of January 1, 2011, the Company's Consolidated Fixed Charge Coverage ratio was lower than the ratio required by the covenants in the Loan and Security Agreement between the Company and Silicon Valley Bank. The bank has granted an amendment and limited waiver, which will not impact operating flexibility going forward.

Foreign Currency Risk. Our purchases of auto parts from our Asian suppliers are denominated in U.S. Dollars; however, a change in the foreign currency exchange rates could impact our product costs over time. Our financial reporting currency is the U.S. Dollar and changes in exchange rates significantly affect our reported results and consolidated trends. For example, if the U.S. Dollar weakens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit, and operating expenses will be higher than if currencies had remained constant. Likewise, if the U.S. Dollar strengthens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit and operating expenses will be lower than if currencies had remained constant. Our operating expenses in the Philippines are generally paid in Philippine Pesos, and as the exchange rate fluctuates, it adversely or favorably impacts our operating results. In light of the above, we believe that a fluctuation of 10% in the Peso/U.S. Dollar exchange rate would have approximately a \$0.3 million impact on our operating expenses for fiscal 2011. Our Canadian website sales are denominated in Canadian Dollars; however, fluctuations in exchange rates from these operations are only expected to have a nominal impact on our operating results due to the relatively small number of sales generated in Canada. We believe it is important to evaluate our operating results and growth rates before and after the effect of currency changes.

[Table of Contents](#)

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements required by this Item 8 are set forth in Part IV, Item 15 of this report and are hereby incorporated into this Item 8 by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed with the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the specified time periods, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of January 1, 2011 pursuant to Rule 13a-15 and 15d-15 of the Exchange Act. Based on that evaluation, the CEO and CFO have concluded that, as of such date, our disclosure controls and procedures were effective to meet the objectives for which they were designed and operated at the reasonable assurance level.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). We assessed the effectiveness of our internal control over financial reporting as of January 1, 2011, based on the "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO framework"). This assessment was conducted utilizing our documentation of policies and procedures, risk control matrices, gap analysis, key process walk-throughs and management's knowledge of and interaction with its controls and testing of our key controls.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projection of any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Based on such assessment and criteria, management has concluded that the internal controls over financial reporting were effective, and were operating at the reasonable assurance level as of January 1, 2011. Our independent registered public accounting firm, Deloitte & Touche LLP, has included an attestation report on our internal control over financial reporting, which is included below.

For purposes of conducting its 2010 evaluation of the effectiveness of the Company's internal control over financial reporting, management has excluded the acquisitions of WAG, completed on August 12, 2010, whose financial statements constitute - 6.4 percent and 12.1 percent of net and total assets, respectively, 14.9 percent of net sales, and 43.2 percent of net loss, of the consolidated financial statement amounts as of and for the year ended January 1, 2011. Refer to "Note 5 – Business Combination" in Part IV, Item 15 of this report for further discussion of the acquisitions and their impact on the Company's Consolidated Financial Statements.

Changes in Internal Control Over Financial Reporting

The Company monitors and evaluates on an ongoing basis its internal control over financial reporting in order to improve its overall effectiveness. In the course of these evaluations, the Company modifies and refines its internal processes as conditions warrant. As required by Rule 13a-15(d), the Company's management, including the Chief Executive Officer and the Chief Financial Officer, also conducted an evaluation of the Company's internal control over financial reporting to determine whether any changes occurred during the quarter ended January 1, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the period covered by this report.

[Table of Contents](#)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
U.S. Auto Parts Network, Inc.
Carson, California

We have audited the internal control over financial reporting of U.S. Auto Parts Network, Inc and subsidiaries (the “Company”) as January 1, 2011 based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in *Management’s Report on Internal Control Over Financial Reporting*, management excluded from its assessment the internal control over financial reporting at Automotive Specialty Accessories and Parts (“WAG”), which was acquired on August 12, 2010, and whose financial statements constitute - 6.4 percent and 12.1 percent of net and total assets, respectively, 14.9 percent of net sales, and 43.2 percent of net loss of the consolidated financial statement amounts as of and for the period ended January 1, 2011. Accordingly, our audit did not include the internal control over financial reporting at WAG. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management’s Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 1, 2011 based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the period ended January 1, 2011 of the Company and our report dated March 16, 2011 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

Los Angeles, CA
March 16, 2011

[Table of Contents](#)

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

(a) *Identification of Directors.* The information under the caption “Election of Directors,” appearing in the Proxy Statement (“Proxy Statement”), is hereby incorporated by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2010.

(b) *Identification of Executive Officers and Certain Significant Employees.* The information under the caption “Executive Compensation and Other Information—Executive Officers,” appearing in the Proxy Statement, is hereby incorporated by reference.

(c) *Compliance with Section 16(a) of the Exchange Act.* The information under the caption “Section 16(a) Beneficial Ownership Reporting Compliance,” appearing in the Proxy Statement, is hereby incorporated by reference.

(d) *Code of Ethics.* The information under the caption “Corporate Governance – Code of Ethics and Business Conduct,” appearing in the Proxy Statement, is hereby incorporated by reference.

(e) *Board Committees.* The information under the caption “Corporate Governance — Board Committees and Meetings,” appearing in the Proxy Statement, is hereby incorporated by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information under the caption “Executive Compensation and Other Information”, appearing in the Proxy Statement, is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information under the captions “Equity Compensation Plans” and “Ownership of Securities by Certain Beneficial Owners and Management,” appearing in the Proxy Statement, is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information under the captions “Corporate Governance — Director Independence” and “Certain Relationships and Related Transactions,” appearing in the Proxy Statement, is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information under the caption “Fees Paid to Independent Registered Public Accounting Firm,” appearing in the Proxy Statement, is incorporated herein by reference.

[Table of Contents](#)

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

(1) *Financial Statements*. The following financial statements of U.S. Auto Parts Network, Inc. are included in a separate section of this Annual Report on Form 10-K commencing on the pages referenced below:

	<u>Page</u>
Report of Deloitte & Touche LLP, independent registered public accounting firm	F-1
Report of Ernst & Young LLP, independent registered public accounting firm	F-2
Consolidated Balance Sheets as of January 1, 2011 and January 2, 2010	F-3
Consolidated Statements of Operations for each of the three years in the period ended January 1, 2011	F-4
Consolidated Statements of Stockholders' Equity for each of the three years in the period ended January 1, 2011	F-5
Consolidated Statements of Cash Flows for each of the three years in the period ended January 1, 2011	F-6
Notes to Consolidated Financial Statements	F-7

Table of Contents

(2) *Financial Statement Schedules.*

All schedules have been omitted because they are not required or the required information is included in our consolidated financial statements and notes thereto.

(3) *Exhibits.*

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

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
2.1*	Acquisition Agreement dated May 19, 2006 by and among U.S. Auto Parts Network, Inc. and Partsbin, Inc., on the one hand, and The Partsbin.com, Inc., All OEM Parts, Inc., Power Host, Inc., Auto Parts Web Solutions, Inc., Web Chat Solutions, Inc., Everything Internet, LLC, Richard E. Pine, Lowell E. Mann, Brian Tinari and Todd Daugherty, on the other hand
2.2	Stock Purchase Agreement executed August 2, 2010 among the Acquisition Sub, WAG, Riverside and the other stockholders of WAG (incorporated by reference to Exhibit 10.57 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 4, 2010)
3.1	Second Amended and Restated Certificate of Incorporation of U.S. Auto Parts Network, Inc. as filed with the Delaware Secretary of State on February 14, 2007 (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007)
3.2	Amended and Restated Bylaws of U.S. Auto Parts Network, Inc. (incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007)
4.1*	Specimen common stock certificate
10.1+*	U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan
10.2+*	Form of Stock Option Agreement under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.
10.3+*	Form of Notice of Grant of Stock Option under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.
10.4+*	Form of Acceleration Addendum to Stock Option Agreement under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.
10.5+*	U.S. Auto Parts Network, Inc. 2007 Omnibus Plan and forms of agreements
10.8+*	Offer Letter of Employment dated May 19, 2006 by and between U.S. Auto Parts Network, Inc. and Richard Pine
10.9+*	Non-Competition Agreement dated May 19, 2006 by and among U.S. Auto Parts Network, Inc. and Richard Pine, Lowell Mann, Brian Tinari and Todd Daugherty
10.10*	Shareholder's Release dated May 19, 2006 by and between U.S. Auto Parts Network, Inc. and Richard Pine
10.23*	Commercial Lease Agreement dated January 1, 2004 by and between U.S. Auto Parts Network, Inc. and Nia Chloe Enterprises, LLC, amended effective February 1, 2010
10.24*	Standard Industrial/Commercial Multi-Tenant Lease — Gross dated October 1, 2006 by and between U.S. Auto Parts Network, Inc. and Margay 2003, LLC, amended effective February 1, 2010
10.25*	Standard Industrial/Commercial Multi-Tenant Lease — Gross dated July 12, 2004 by and between U.S. Auto Parts Network, Inc. and Isadore Socransky, amended effective February 1, 2010
10.26*	Lease dated November 30, 2004 by and between U.S. Auto Parts Network, Inc. and William Coats
10.27†*	Catalog License and Parts Purchase Agreement dated November 20, 2006 by and between U.S. Auto Parts Network, Inc. and WORLD PAC, Inc.
10.29†*	Services Agreement dated October 3, 2006 by and between U.S. Auto Parts Network, Inc. and Efficient Frontier, Inc.

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
10.32+*	Offer Letter of Employment dated January 1, 2006 by and between U.S. Auto Parts Network, Inc. and Houman Akhavan
10.33+	Form of Indemnification Agreement for Officers and Directors (incorporated by reference to Exhibit 10.33 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2010)
10.35*	Deeds of Assignment and Declarations of Trust executed September 2006 regarding MBS Tek Corporation stock transfer
10.36	Purchase Agreement, dated April 20, 2007, by and among U.S. Auto Parts Network, Inc., Access Worldwide Communications, Inc. and their respective Philippine affiliates (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2007)
10.37	Lease Agreements, dated August 8, 2007, by and among MBS Tek Corporation and Roshan Commercial Corp. (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 2, 2007)
10.38	Form of Suppliers' Agreement entered into between U.S. Auto Parts Network, Inc. and certain of its U.S. based suppliers and primary drop-ship vendors (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 2, 2007)
10.39+	Employment Agreement dated March 29, 2010 between U.S. Auto Parts Network, Inc. and Shane Evangelist (incorporated by reference to Exhibit 10.39 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2010)
10.40+	Non-Qualified Stock Option Agreement dated October 15, 2007 between U.S. Auto Parts Network, Inc. and Shane Evangelist (incorporated by reference to Exhibit 99.3 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 17, 2007)
10.41+	Non-Qualified Stock Option Agreement dated October 15, 2007 (performance grant) between U.S. Auto Parts Network, Inc. and Shane Evangelist (incorporated by reference to Exhibit 99.4 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 17, 2007)
10.42+	2007 New Employee Incentive Plan (incorporated by reference to Exhibit 99.5 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 17, 2007)
10.43	Lease Agreement, dated October 11, 2007, by and between MBS Tek Corporation and Avera Holding Corporation (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 14, 2007)
10.44+	Employment Agreement, dated March 29, 2010, between the Company and Aaron Coleman (incorporated by reference to Exhibit 10.44 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2010)
10.45	Support Continuity Agreement, dated April 28, 2008, between the Company and Alexander Adegan (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 28, 2008)
10.46	Consulting Agreement, dated April 28, 2008, among the Company, uParts.com, Inc. and Alexander Adegan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 28, 2008)
10.47+	Non-Incentive Stock Option Agreement, dated April 28, 2008, between the Company and Alexander Adegan (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 28, 2008)

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
10.48+	Non-Qualified Stock Option Agreement, dated May 15, 2008, by and between the Company and Shane Evangelist (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 15, 2008)
10.49	Stipulation of settlement in the matter entitled: In re U.S. Auto Parts Network, Inc. Securities Litigation, Case No. CV 07-2030-GW (JC) (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 6, 2008)
10.50+	Separation Agreement and Release of Claims, dated December 9, 2008, between the Company and Michael J. McClane (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 9, 2008)
10.51	Consulting Agreement, dated December 9, 2008, between the Company and Michael J. McClane (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 9, 2008)
10.52+	Employment Agreement, dated March 29, 2010 between the Company and Theodore Sanders (incorporated by reference to Exhibit 10.53 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2010)
10.53+	Non-Qualified Stock Option Agreement, dated February 16, 2009, between the Company and Theodore Sanders (incorporated by reference to Exhibit 10.63 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on February 17, 2009)
10.54+	Non-Qualified Stock Option Agreement (performance grant), dated February 16, 2009, between the Company and Theodore Sanders (incorporated by reference to Exhibit 10.64 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on February 17, 2009)
10.55	Commercial Lease Agreement dated December 16, 2008 by and between U.S. Auto Parts Network, Inc. and Ashley Indian River, LLC (incorporated by reference to Exhibit 10.66 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 26, 2009)
10.56	Commercial lease dated January 7, 2010 by and between U.S. Autoparts Network Philippines Corporation and Robinsons Land Corporation (incorporated by reference to Exhibit 10.56 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2010)
10.58	Guarantee executed August 2, 2010 by the Company (incorporated by reference to Exhibit 10.58 to the Company's Current Report on Form 8-K filed with Securities and Exchange Commission on August 4, 2010)
10.59	Loan and Security Agreement, dated August 13, 2010, between Bank, USAPN, ASAP, Go Fido Inc., Parts Bin, Lobo, Whitney, Value, Private Label, Pacific, AutoMD, and Local Body Shops (incorporated by reference to Exhibit 10.59 to the Company's Quarterly Report on Form 10-Q filed with the Securities Exchange and Commission on August 17, 2010)
10.63+	2011 Base Salaries and Target Bonuses of certain officers (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 9, 2010)
10.64	Sublease dated December 4, 2007 by and between Marketing Werks, Inc. and J.C. Whitney & Co.
10.65	Second Amendment To Lease Agreement dated February 1, 2008 by and between JCM Management LLC and Stylin' Concepts Corp.
10.66	Amendment No. 1 to Loan and Security Agreement and Limited Waiver, dated February 28, 2011, by and among Silicon Valley Bank and USAPN, ASAP, Go Fido Inc., Parts Bin, Lobo, Whitney, Value, Private Label, Pacific, AutoMD, and Local Body Shops (incorporated by reference to Exhibit 10.70 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 4, 2011)

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
16.1	June 21, 2010 Letter from E&Y to the SEC (incorporated herein by reference to the Company's Current Report on Form 8-K filed with the SEC on June 23, 2010)
21.1	Subsidiaries of U.S. Auto Parts Network, Inc.
23.1	Consent of Independent Registered Public Accounting Firm
23.2	Consent of Independent Registered Public Accounting Firm
31.1	Certification of the principal executive officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the principal financial officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*	Incorporated by reference to the exhibit of the same number from the registration statement on Form S-1 of U.S. Auto Parts Network, Inc. (File No. 333-138379) initially filed with the Securities and Exchange Commission on November 2, 2006, as amended.
+	Indicates a management contract or compensatory plan or arrangement
†	U.S. Auto Parts Network, Inc. has been granted confidential treatment with respect to certain portions of this exhibit (indicated by asterisks), which have been separately filed with the Securities and Exchange Commission.

[Table of Contents](#)

SIGNATURES

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

Date: March 16, 2011

U.S. AUTO PARTS NETWORK, INC.

By: /s/ Shane Evangelist
Shane Evangelist
Chief Executive Officer

POWER OF ATTORNEY

We, the undersigned officers and directors of U.S. Auto Parts Network, Inc., do hereby constitute and appoint Shane Evangelist and Theodore Sanders, and each of them, our true and lawful attorneys-in-fact and agents, each with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this report, and to file the same, with exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby, ratifying and confirming all that each of said attorneys-in-fact and agents, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report on Form 10-K has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Shane Evangelist</u> Shane Evangelist	Chief Executive Officer and Director (principal executive officer)	March 16, 2011
<u>/s/ Theodore Sanders</u> Theodore Sanders	Chief Financial Officer (principal financial and accounting officer)	March 16, 2011
<u>/s/ Robert J. Majteles</u> Robert J. Majteles	Chairman of the Board	March 16, 2011
<u>/s/ Joshua L. Berman</u> Joshua L. Berman	Director	March 16, 2011
<u>/s/ Fredric W. Harman</u> Fredric W. Harman	Director	March 16, 2011
<u>/s/ Sol Khazani</u> Sol Khazani	Director	March 16, 2011
<u>/s/ Warren B. Phelps III</u> Warren B. Phelps III	Director	March 16, 2011
<u>/s/ Jeffrey A. Schwartz</u> Jeffrey A. Schwartz	Director	March 16, 2011
<u>/s/ Ellen F. Siminoff</u> Ellen F. Siminoff	Director	March 16, 2011

Table of Contents

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

<u>Report of Deloitte & Touche LLP, independent registered public accounting firm</u>	F-1
<u>Report of Ernst & Young LLP, independent registered public accounting firm</u>	F-2
<u>Consolidated Balance Sheets as of January 1, 2011 and January 2, 2010</u>	F-3
<u>Consolidated Statements of Operations for each of the three years in the period ended January 1, 2011</u>	F-4
<u>Consolidated Statements of Stockholders' Equity for each of the three years in the period ended January 1, 2011</u>	F-5
<u>Consolidated Statements of Cash Flows for each of the three years in the period ended January 1, 2011</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
U.S. Auto Parts Network, Inc.
Carson, CA

We have audited the accompanying consolidated balance sheet of U.S. Auto Parts Network, Inc. and subsidiaries (the “Company”) as of January 1, 2011 and the related consolidated statements of operations, stockholders’ equity, and cash flows for the period ended January 1, 2011. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of U.S. Auto Parts, Inc. and subsidiaries as of January 1, 2011 and the results of their operations and their cash flows for the period ended January 1, 2011, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of January 1, 2011, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 16, 2011 expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Los Angeles, CA
March 16, 2011

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
U.S. Auto Parts Network, Inc.

We have audited the accompanying consolidated balance sheet of U.S. Auto Parts Network, Inc. and subsidiaries (the Company) as of January 2, 2010, and the related consolidated statements of operations, stockholders' equity and cash flows for the two years in the period ended January 2, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of U.S. Auto Parts Network, Inc. and subsidiaries at January 2, 2010, and the consolidated results of their operations and their cash flows for the two years in the period ended January 2, 2010, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Los Angeles, California
March 12, 2010

[Table of Contents](#)

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

CONSOLIDATED BALANCE SHEETS

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

	January 2, 2010	January 1, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 26,251	\$ 17,595
Short-term investments	11,071	1,062
Accounts receivable, net of allowances of \$135 and \$372, respectively	3,383	6,849
Inventory	18,610	48,100
Deferred income taxes	1,513	359
Other current assets	<u>3,148</u>	<u>5,646</u>
Total current assets	63,976	79,611
Property and equipment, net	12,405	33,140
Intangible assets, net	3,114	18,718
Goodwill	9,772	17,137
Deferred income taxes	10,985	—
Investments	4,264	4,141
Other non-current assets	<u>98</u>	<u>790</u>
Total assets	<u>\$104,614</u>	<u>\$153,537</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 11,371	\$ 31,660
Accrued expenses	8,038	15,487
Current portion of long-term debt	—	6,125
Current portion of capital leases payable	—	132
Other current liabilities	<u>2,518</u>	<u>5,522</u>
Total current liabilities	21,927	58,926
Long-term debt, net of current portion	—	17,875
Capital leases payable, net of current portion	—	185
Deferred income taxes	—	3,046
Other non-current liabilities	<u>—</u>	<u>701</u>
Total liabilities	21,927	80,733
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value; 100,000,000 shares authorized at January 2, 2010 and January 1, 2011; 29,893,631 and 30,429,376 shares issued and outstanding at January 2, 2010 and January 1, 2011, respectively	30	30
Additional paid-in capital	150,084	153,962
Accumulated other comprehensive income	84	249
Accumulated deficit	<u>(67,511)</u>	<u>(81,437)</u>
Total stockholders' equity	<u>82,687</u>	<u>72,804</u>
Total liabilities and stockholders' equity	<u>\$104,614</u>	<u>\$153,537</u>

See accompanying notes.

[Table of Contents](#)

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

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
Net sales	\$ 153,424	\$ 176,288	\$ 262,277
Cost of sales (2)	100,869	112,415	172,668
Gross profit	52,555	63,873	89,609
Operating expenses:			
Marketing (1)	22,965	23,419	38,757
General and administrative(1)	18,234	19,640	28,628
Fulfillment(1)	9,116	11,437	14,946
Technology(1)	3,642	4,467	5,902
Amortization of intangibles and impairment loss	23,897	661	2,804
Impairment loss on goodwill	4,429	—	—
Total operating expenses	82,283	59,624	91,037
(Loss) income from operations	(29,728)	4,249	(1,428)
Other income (expense):			
Other income	38	2	191
Interest income (expense)	962	189	(471)
Total other income (expense)	1,000	191	(280)
(Loss) income before income taxes	(28,728)	4,440	(1,708)
Income tax (benefit) provision	(11,822)	3,123	12,218
Net (loss) income	\$ (16,906)	\$ 1,317	\$ (13,926)
Basic net (loss) income per share	\$ (0.57)	\$ 0.04	\$ (0.46)
Diluted net (loss) income per share	\$ (0.57)	\$ 0.04	\$ (0.46)
Shares used in computation of basic net (loss) income per share	29,846,757	29,851,873	30,269,462
Shares used in computation of diluted net (loss) income per share	29,846,757	30,809,111	30,269,462

(1) Includes share-based compensation expense related to option grants, as follows:

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
Marketing expense	\$ 344	\$ 436	\$ 321
General and administrative expense	2,181	2,276	1,869
Fulfillment expense	149	213	376
Technology expense	227	345	176
Total share-based compensation expense	\$ 2,901	\$ 3,270	\$ 2,742

(2) Excludes depreciation and amortization expense related to sales. Such expense is included in marketing, general and administrative and fulfillment costs as described in "Note 1 – Summary of Significant Accounting Policies and Nature of Operations" below.

See accompanying notes.

[Table of Contents](#)

U.S AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

	Common Stock		Additional Paid-in- Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity	Comprehensive (Loss) Income for the Period
	Shares	Amount					
Balance, December 31, 2007	<u>29,846,757</u>	<u>\$ 30</u>	<u>\$143,223</u>	<u>\$ 312</u>	<u>\$ (51,922)</u>	<u>\$ 91,643</u>	
Net loss	—	—	—	—	(16,906)	(16,906)	\$ (16,906)
Share-based compensation	—	—	3,185	—	—	3,185	
Unrealized loss on investments, net of tax of \$59	—	—	—	(90)	—	(90)	(90)
Effect of changes in foreign currencies	—	—	—	(310)	—	(310)	(310)
Total comprehensive income (loss)							<u>\$ (17,306)</u>
Balance, December 31, 2008	<u>29,846,757</u>	<u>\$ 30</u>	<u>\$146,408</u>	<u>\$ (88)</u>	<u>\$ (68,828)</u>	<u>\$ 77,522</u>	
Net Income	—	—	—	—	1,317	1,317	\$ 1,317
Issuance of shares in connection with stock option exercise	46,874	—	162	—	—	162	
Share-based compensation	—	—	3,514	—	—	3,514	
Unrealized loss on investments, net of tax of \$24	—	—	—	19	—	19	19
Effect of changes in foreign currencies	—	—	—	153	—	153	153
Total comprehensive income (loss)							<u>\$ 1,489</u>
Balance, January 2, 2010	<u>29,893,631</u>	<u>\$ 30</u>	<u>\$150,084</u>	<u>\$ 84</u>	<u>\$ (67,511)</u>	<u>\$ 82,687</u>	
Net Income	—	—	—	—	(13,926)	(13,926)	\$ (13,926)
Issuance of shares in connection with stock option exercises	323,103	—	999	—	—	999	
Share-based compensation	212,642	—	2,879	—	—	2,879	
Unrealized gain on investments, net of tax of \$1	—	—	—	15	—	15	15
Effect of changes in foreign currencies	—	—	—	150	—	150	150
Total comprehensive income (loss)							<u>\$ (13,761)</u>
Balance, January 1, 2011	<u>30,429,376</u>	<u>\$ 30</u>	<u>\$153,962</u>	<u>\$ 249</u>	<u>\$ (81,437)</u>	<u>\$ 72,804</u>	

[Table of Contents](#)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
Operating activities			
Net (loss) income	\$ (16,906)	\$ 1,317	\$ (13,926)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Depreciation and amortization	3,674	4,910	9,466
Amortization of intangibles	4,958	661	2,804
Deferred income taxes	(11,703)	3,634	12,572
Share-based compensation	2,901	3,270	2,742
Impairment loss on goodwill and intangibles	23,368	—	—
Amortization of deferred financing costs	—	—	50
Loss (gain) from disposition of assets	26	—	(5)
Changes in operating assets and liabilities:			
Accounts receivable	1,553	(2,030)	919
Inventory	280	(7,700)	(17,124)
Prepaid expense and other current assets	(300)	(1,055)	(910)
Other noncurrent assets	15	(3)	(123)
Accounts payable and accrued expenses	(5,000)	7,560	(686)
Other current liabilities	130	1,023	1,812
Other noncurrent liabilities	—	—	700
Net cash provided by (used in) operating activities	2,996	11,587	(1,709)
Investing activities			
Additions to property and equipment	(4,331)	(8,400)	(12,068)
Acquisition of assembled workforce and other intangibles	(641)	(739)	(1,012)
Cash paid for acquisition, net of cash acquired	—	—	(27,500)
Proceeds from sale of marketable securities	21,650	2,150	29,641
Purchases of marketable securities	(5,500)	(11,090)	(19,540)
Changes in restricted cash	—	—	(319)
Purchases of company-owned life insurance	—	—	(250)
Net cash provided by (used in) investing activities	11,178	(18,079)	(31,048)
Financing activities			
Proceeds from long-term debt	—	—	25,000
Payments made on long-term debt	(1,000)	—	(1,000)
Changes in book overdraft	—	—	(529)
Payments of debt financing costs	—	—	(467)
Payments of short-term financing	(75)	(47)	(77)
Proceeds from sale of common stock and exercise of stock options	—	162	956
Net cash (used in) provided by financing activities	(1,075)	115	23,883
Effect of exchange rate changes on cash	(25)	155	218
Net change in cash and cash equivalents	13,074	(6,222)	(8,656)
Cash and cash equivalents, beginning of period	19,399	32,473	26,251
Cash and cash equivalents, end of period	\$ 32,473	\$ 26,251	\$ 17,595
Supplemental disclosure of non-cash investing and financing activities:			
Accrued asset purchases	527	451	1,691
Property acquired under capital lease	—	—	370
Estimated purchase price adjustment	—	—	994
Unrealized (loss) gain on investments	(149)	19	15
Supplemental disclosure of cash flow information:			
Cash paid during the period for income taxes	\$ 87	\$ 589	\$ 131
Cash paid during the period for interest	103	2	127

See accompanying notes.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

The Company is a Delaware C corporation and is headquartered in Carson, California. The Company also has employees located in Nashville, Tennessee, Lenexa, Kansas, Chesapeake, Virginia, LaSalle, Chicago, as well as in the Philippines.

Change in Fiscal Year

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

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. generally accepted accounting principles (“US GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, but are not limited to, the valuation of investments, valuation of inventory, valuation of deferred tax assets and liabilities, valuation of intangible assets, including goodwill, and recoverability of software development costs. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Company considers all money market funds and short-term marketable securities purchased with original maturities of ninety days or less to be cash equivalents. In connection with our acquisition of Automotive Specialty Accessories and Parts (“WAG”), restricted cash of \$319,000 was included in other current assets as of January 1, 2011. The restricted cash was related to a collateral paid to the landlord for the sublease of WAG’s headquarter office in Chicago and a security deposit made to a payment processor for online market place transactions. The entire balance of \$319,000 was released from the restriction and recorded as cash and cash equivalent in February 2011.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, marketable securities, accounts receivable and accounts payable approximate fair value at January 2, 2010 and January 1, 2011 due to their short-term maturities. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of our long-term debt under credit facility approximates its carrying amount.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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. The allowance for doubtful accounts totaled \$0.1 million and \$0.4 million at January 2, 2010 and January 1, 2011, respectively.

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

Marketable Securities and Investments

Marketable securities and investments are comprised of closed-end funds primarily invested in Auction Rate Preferred Securities ("ARPS"), Mutual Funds, Certificates of Deposit, Municipal Bonds, and US Treasuries. The underlying investments in ARPS are tax-exempt municipal bonds with maturities of thirty or more years, for which the interest rates are reset through a "Dutch auction" every seven days. In accordance with Accounting Standards Codification ("ASC") Topic 320, *Investments – Debt and Equity Securities* ("ASC 320") and based on the Company's ability to market and sell these instruments, the Company classifies ARPS as available-for-sale and carries them at fair value. US Treasuries are classified as short-term investments with maturities of less than 12 months and it is the intention of management to hold these securities to maturity.

During the twelve months ended December 31, 2008, the Company discounted the fair value of the investment in ARPS for illiquidity in the market as further described in Note 3, under the caption "*Financial Assets Valued on a Recurring Basis*". In fiscal 2009, there was an increase in liquidity which was evidenced by redemptions of \$2.2 million (33% of the carrying amount at December 31, 2008 balance). For the period from June 30, 2008 to January 1, 2011, we have received partial redemptions at par on ARPS totaling \$3.5 million.

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 fiscal 2009 and 2010. In February 2008, certain ARPS held by the Company failed at auctions, as described more fully in Note 3, under the caption "*Financial Assets Valued on a Recurring Basis*".

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 assure inventory availability. Inventory is reported at the lower of cost or market, adjusted for slow moving, obsolete or scrap product. Inventory at January 2, 2010 and January 1, 2011 were \$18.6 million and \$48.1 million, 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* ("ASC 350-50") and ASC 350-50 *Intangibles – Goodwill and Other – Internal-Use Software* ("ASC 350-40"), 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

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

software project. Capitalization of such costs ceases when the project is substantially complete and ready for its intended use. The Company capitalized \$5.7 million and \$2.0 million during fiscal 2009 and 2010, respectively. These amounts are amortized on a straight-line basis over two to five years once the software is placed into use.

Long-Lived Assets and Intangibles

The Company accounts for the impairment and disposition of long-lived assets, including intangibles subject to amortization, in accordance with ASC 360 *Property, Plant and Equipment* (“ASC 360”). Management assesses potential impairments whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. 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. During calendar year 2008, the Company recorded a non-cash impairment charge on long-lived assets totaling \$18.4 million as further described in Note 6, under the caption “*Goodwill and Intangibles*”. The Company did not recognize any impairment losses for fiscal 2009 and fiscal 2010.

Goodwill and Indefinite-Lived Intangibles

The Company accounts for goodwill and indefinite-lived intangible assets in accordance with ASC 350. Under ASC 350, goodwill and intangible assets with indefinite lives are not amortized but are tested for impairment annually or more frequently if events or circumstances occur that would indicate a reduction in fair value. In addition, the Company identified a single reporting unit (the Company itself) in accordance with ASC 280. The goodwill impairment test is a two-step impairment test. The first step compares the fair value of each reporting unit with its carrying amount including goodwill. The Company estimates the fair value of the reporting unit based on an equal weighting of two market approaches and an income approach, which utilizes discounted future cash flows. The market approaches utilized market multiples of invested capital from 1) comparable publicly traded companies and 2) comparable transactions. The market multiples from invested capital include revenues, total assets, book equity plus debt and earnings before interest, taxes, depreciation and amortization (“EBITDA”). Assumptions critical to the fair value estimates under the discounted cash flow model include discount rates, cash flow projections, projected long-term growth rates and the determination of terminal values. Management has performed a sensitivity analysis on its significant assumptions and has determined that a change in its assumptions within selected sensitivity testing levels would not impact its conclusion. The excess of fair value over carrying value for our reporting unit as of October 31, 2010, the annual testing date, was approximately \$187 million, and there would have to be a 65% decrease in the fair value of the reporting unit to fail step 1. If the carrying amount exceeds fair value, then the second step of the impairment test is performed to measure the amount of any impairment loss.

Impairment losses will be recognized in operating results. During calendar year 2008, the Company recorded a non-cash impairment charge on goodwill and intangible assets with indefinite life totaling \$5.1 million, as further described in Note 6, under the caption “*Goodwill and Intangibles*.” The Company did not recognize any impairment losses for fiscal 2009 and 2010.

Deferred Catalog Expenses

Deferred catalog expenses consist of third-party direct costs including primarily creative design, paper, printing, postage and mailing costs for all Company direct response catalogs. Such costs are capitalized as deferred catalog expenses and are amortized over their expected future benefit. Each catalog is fully amortized within nine months. Deferred catalog expenses are included in other current assets and amount to \$1.0 million at January 1, 2011. There were no deferred catalog expenses at January 2, 2010 as the catalog relates to the acquisition of WAG discussed in Note 5.

Deferred Financing Costs

On August 13, 2010, the Company entered into a credit facility with Silicon Valley Bank. The credit facility is comprised of a \$25 million term loan and a \$10 million revolving line of credit. In connection with the credit facility, the Company paid \$0.5 million in fees. These fees were recorded as deferred financing costs in other current assets and other non-current assets. Deferred financing costs are being amortized over the life of the loan using the straight-line method as it is not significantly different from effective interest method. As of January 1, 2011, the remaining deferred financing costs were \$0.4 million.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Revenue Recognition

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

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

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

Revenue from sales of advertising is recorded when performance requirements of the related advertising program agreement are met. During fiscal 2010, fiscal 2009 and calendar year 2008, the advertising revenue represented approximately 1% of our total revenue.

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 gross.

Return allowances, which reduce product revenue by the Company's best estimate of expected product returns, are estimated using historical experience. The Company generally requires payment by credit card at the point of sale. Amounts received prior to when the Company delivers 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. Current discount offers and inducement offers are classified as an offsetting amount in net sales.

Sales discounts are recorded in the period in which the related sale is recognized. Sales returns and allowances are estimated based on historical amounts. Credits are issued to customers for returned products. Credits amounted to \$19.5 million, \$19.0 million and \$25.7 million for calendar year 2008, fiscal 2009 and fiscal 2010, respectively. No customer accounted for more than 10% of the Company's net sales in the past three years.

The following table provides an analysis of the reserve for sales returns and the reserve for doubtful accounts:

<u>(In thousands)</u>	<u>Balance at Beginning of Period</u>	<u>Charged to Revenue, Cost or Expenses</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
Year Ended December 31, 2008				
Reserve for sales returns	\$ 710	(48)	—	\$ 662
Reserve for doubtful accounts	12	119	(16)	115
Fifty-Two Weeks Ended January 2, 2010				
Reserve for sales returns	\$ 662	295	—	\$ 957
Reserve for doubtful accounts	115	27	(7)	135
Fifty-Two Weeks Ended January 1, 2011				
Reserve for sales returns	\$ 957	359	—	\$ 1,316
Reserve for doubtful accounts	135	380	(143)	372

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Interest Income (Expense)

Interest income consists primarily of interest income on investments. Interest expense consists primarily of interest expense on our outstanding loan balances and capital leases.

Other Income

Other income consists of miscellaneous income such as gain from disposition of assets.

Cost of Goods Sold

Cost of goods sold consists of the direct costs associated with procuring parts from suppliers and delivering products to customers. These costs include direct product costs, purchase discounts, outbound freight and, warehouse supplies. The Company includes freight and shipping costs in cost of goods sold. Total freight and shipping expense included in cost of goods sold for calendar year 2008, fiscal 2009 and fiscal 2010 were \$19.3 million, \$19.2 million and \$31.6 million, respectively. Depreciation and amortization directly related to sales are excluded from cost of goods sold and included in marketing, general and administrative and fulfillment costs as noted below.

Marketing

Marketing costs, including advertising, are expensed as incurred. The majority of marketing expense is paid to Internet search engine service providers and Internet commerce facilitators. For calendar year 2008, fiscal 2009 and fiscal 2010, the Company recognized advertising costs of \$10.1 million, \$11.4 million and \$16.5 million, respectively. Marketing costs also include depreciation and amortization expense directly related to sales.

General and Administrative

General and administrative expense consist 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 directly related to sales.

Fulfillment

Fulfillment costs consist primarily of payroll and related costs associated with warehouse employees, facility rent, building maintenance, and other costs associated with inventory management and wholesale operations. Fulfillment costs also include depreciation and amortization expense directly related to sales.

Technology

Technology expenses consist primarily of payroll and related expenses, and costs associated with computer support, information technology, software development and connectivity.

Comprehensive Income

The Company reports comprehensive income in accordance with ASC 220 *Comprehensive Income*. Accumulated other comprehensive income includes net income or loss, foreign currency translation adjustments related to the Company's foreign operations and unrealized gains and losses from investments in ARPS that hold tax-exempt municipal bonds and investments in mutual funds that hold debt securities.

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 is expensed on a straight-line basis over the term of the lease.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 (loss) in stockholders' equity.

Income Taxes

The Company accounts for income taxes in accordance with ASC 740 *Income Taxes*. 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 reserve 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, projected future taxable income, tax planning strategies and recent financial operations.

Prior to the acquisition of WAG, the Company concluded that it was more likely than not that we would realize the deferred tax assets in all jurisdictions. However, with the acquisition of WAG, based largely on the weight of the combined cumulative three-year adjusted loss position, it was determined that it was not more likely than not that the Company would realize its net deferred tax assets. Therefore, a valuation allowance of \$18.3 million was recorded as of January 1, 2011, of which \$4.7 million was recorded against the acquired deferred tax assets of WAG as of August 12, 2010.

The Company utilizes a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. As of January 1, 2011, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. The Company's policy is to record interest and penalties as income tax expense.

Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC 718 *Compensation – Stock Compensation*, which was adopted on January 1, 2006. All stock options issued to employees are recognized as share-based compensation expense in the financial statements based on their respective grant date fair values, and are recognized within the statement of operations as general and administrative, marketing, fulfillment or technology, 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, which the Company estimates the fair value using a Monte Carlo model. The determination of the fair value of share-based payment awards utilizing the Black-Scholes and Monte Carlo models is affected by the Company's stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends.

The Company estimates volatility using historical volatilities of similar public entities. The expected life of the awards is based on a simplified method that defines the life as the average of the contractual term of the options and the weighted average vesting period for all open tranches. Prior to our initial public offering in February 2007, we did not have a history of market prices of our common stock. Due to the limited period time our equity shares have been publicly traded, we do not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The risk-free interest rate assumption is based on observed interest rates appropriate for the expected life of awards. The dividend yield assumption is based on the Company's expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures 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 goods or services from non-employee directors in accordance with the provisions of ASC 718.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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.

Segment Data

The Company manages its operations on a consolidated basis for purposes of assessing performance and making operating decisions. Accordingly, the Company operates in one reportable segment and reporting revenues by product line or geographic location is impracticable. In accordance with the provisions of *ASC 280 Segment Reporting*, our acquisition of WAG does not meet the criteria for separate reporting of WAG's operations. Our single reportable segment remained consistent in fiscal 2010. See "Note 6- Goodwill and Intangibles" below for further discussion.

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2009-13, *Revenue Arrangements with Multiple Deliverables*, which amends Accounting Standards Codification ("ASC") Topic 605, which modifies the accounting for multiple deliverable revenue arrangements to enable vendors to account for deliverables separately rather than as a combined unit. The adoption will not have a material effect on the consolidated financial statements.

In January 2010, the FASB issued ASU 2010-6, *Improving Disclosures About Fair Value Measurements*, which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. ASU 2010-6 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. The adoption of ASU 2010-6 did not have a material effect on the consolidated financial statements.

Note 2 – Investments

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

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

As of January 2, 2010, the Company held the following securities and investments, recorded at fair value (in thousands):

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
Auction rate preferred securities in municipal and state agencies ⁽¹⁾	\$ 4,350	\$—	\$ (86)	\$ 4,264
US Treasury Bills with maturities of less than one year ⁽³⁾	4,106	5	—	4,111
Certificates of Deposit and Municipal Bonds ⁽⁴⁾	6,984	—	(24)	6,960
Total	\$ 15,440	\$ 5	\$ (110)	\$ 15,335

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

- (2) 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.
- (3) US Treasury Bills are short-term investments with maturities of less than 12 months. These securities matured in fiscal 2010.
- (4) Certificates of Deposit and Municipal Bonds represent short-term investments with maturities of less than 12 months which are classified as investments available-for-sale and recorded at fair market value, based on quoted prices of identical assets that are trading in active markets as of the end of the period for which the values are determined.

Proceeds from the sale of available-for-sale securities are disclosed separately in the accompanying consolidated statements of cash flow. For fiscal 2010, the Company recognized gross realized gain and losses of \$27 and \$8, (in thousands) respectively. For fiscal 2009 and calendar year 2008, the Company recognized no gross realized gain and losses.

The accumulated unrealized net loss on the securities and investments at January 1, 2011 and January 2, 2010 was \$0.1 million.

Note 3 – Fair Value Measurements

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

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

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

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

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

Financial Assets Valued on a Recurring Basis

As of January 1, 2011 and January 2, 2010, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company's financial instruments, including investments associated with the auction rate preferred securities ("ARPS"). The Company measures the following financial assets at fair value on a recurring basis. The fair value of these financial assets was determined using the following inputs at January 1, 2011 and January 2, 2010 (in thousands):

	As of January 1, 2011			
	Total	Level 1	Level 2	Level 3
<u>Assets:</u>				
Cash and cash equivalents ⁽¹⁾	\$17,595	\$17,595	\$ —	\$ —
Short-term investments ⁽²⁾	1,062	1,062	—	—
Non-current investments available-for-sale ⁽³⁾	4,141	—	—	4,141
	<u>\$22,798</u>	<u>\$18,657</u>	<u>\$ —</u>	<u>\$4,141</u>
	As of January 2, 2010			
	Total	Level 1	Level 2	Level 3
<u>Assets:</u>				
Cash and cash equivalents ⁽¹⁾	\$26,251	\$26,251	\$ —	\$ —
Short-term investments ⁽⁴⁾	6,965	6,965	—	—
Non-current investments available-for-sale ⁽³⁾	4,264	—	—	4,264
	<u>\$37,480</u>	<u>\$33,216</u>	<u>\$ —</u>	<u>\$4,264</u>

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

- (1) Cash and cash equivalents consists primarily of money market funds with original maturity dates of three months or less at the date of purchase, for which the Company determines fair value through quoted market prices.
- (2) Short-term investments consist of mutual funds. Short-term investments are classified as investments available-for-sale and recorded at fair market value, based on quoted prices of identical assets that are trading in active markets as of the end of the period for which the values are determined.
- (3) As of January 1, 2011, the Company had invested \$4.2 million (par value) in ARPS, which are classified as available-for-sale securities and reflected at \$4.1 million (fair value), which includes an unrealized loss of \$0.1 million. The Company has included its investments related to ARPS in the Level 3 category.
- (4) As of January 2, 2010, short-term investments consist of municipal bonds and certificates of deposit. Short-term investments are 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.

Before utilizing Level 3 inputs in our fair value measurement, the Company considered significant Level 2 observable inputs of similar assets in active and inactive markets. The Company's broker dealer received estimated market values from an independent pricing service as of the balance sheet date and the anticipated future market for such investments. These investments consist solely of collateralized debt obligations supported by municipal and state agencies; do not include mortgage-backed securities or student loans; have redemption features that call for redemption at 100% of par value; and have a current credit rating of A or AAA. However, the fact that there is not an active market to liquidate these investments was considered in classifying them as Level 3. Due to the uncertainty with regard to the short-term liquidity of these securities, the Company determined that it could not rely on par value to represent fair value. Therefore, the Company estimated the fair values of these securities utilizing a discounted cash flow valuation model as of January 1, 2011 and January 2, 2010. This analysis considered the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation the security will have a successful auction or market liquidity. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company.

As a result of the temporary declines in fair value for the Company's ARPS, which the Company generally attributes to liquidity issues rather than credit issues, the Company recorded an unrealized loss of \$0.1 million to accumulated other comprehensive income as of January 1, 2011 and January 2, 2010. Due to the Company's belief that the market for these collateralized instruments may take in excess of twelve months to fully recover, the Company has classified these investments as noncurrent and has included them in investments on the consolidated balance sheets at January 1, 2011 and January 2, 2010. As of January 1, 2011, the Company continues to earn interest on all of its ARPS instruments. Any future fluctuation in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income. If the Company determined that any decrease in the value of the instruments was other-than-temporary, it would record a charge to earnings as appropriate. The Company is not certain how long it may be required to hold each security. However, given the Company's current cash position, liquid cash equivalents and expected cash provided by operations, it believes it has the ability to hold, and intends to continue to hold the ARPS as long-term investments until the market stabilizes.

During fiscal 2009 and 2010, there were no transfers of level 1 and level 2 assets. The following tables present the Company's ARPS measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at January 1, 2011 and January 2, 2010 (in thousands):

	Long-Term Investments
Balance as of January 2, 2010	\$ 4,264
Redemption	(125)
Unrealized gains	2
Balance as of January 1, 2011	<u>\$ 4,141</u>
	Long-Term Investments
Balance as of January 1, 2009	\$ 6,351
Redemption	(2,150)
Unrealized gains	63
Balance as of January 2, 2010	<u>\$ 4,264</u>

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Non-Financial Assets Valued on a Non-Recurring Basis

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

As of January 1, 2011 and January 2, 2010, the Company's long-lived and indefinite-lived intangible assets did not indicate a potential impairment under the provisions of ASC 350 and ASC 360 and, as such, they were not measured at fair value.

The Company's long-lived assets and indefinite lived intangible assets were determined to be impaired as of June 30, 2008 and December 31, 2008. These assets were measured at fair value using significant unobservable inputs (level 3), as described in Note 6, under the caption "*Goodwill and Intangible Assets*".

Note 4 – Property and Equipment, Net

In August 2010, in connection with the acquisition of WAG, the Company allocated \$16.4 million of the purchase price to the following property and equipment:

	<u>Weighted-Average Useful Life</u>	<u>Gross Carrying Amount</u> (in thousands)
Land	Indefinite life	\$ 630
Building	21 years	10,680
Furniture and fixtures	3 years	403
Machinery and equipment	2-3 years	3,843
Leasehold improvements	5 years	561
CIP		313
Total		<u>\$ 16,430</u>

The acquired property and equipment are being depreciated on a straight line basis in accordance with their estimated useful life. See Note 5 below for further details on the acquisition.

The Company's fixed assets consisted of computer software (internally developed and purchased), machinery and equipment, furniture and fixtures, and vehicles, and are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable and amortizable assets to operations over their estimated service lives. Depreciation expense for calendar year 2008, fiscal 2009 and fiscal 2010 was \$2.0 million, \$2.0 million and \$3.4 million, respectively. Software amortization expense for the same periods was \$1.7 million, \$2.9 million and \$6.1 million, respectively. The cost and related accumulated depreciation of assets retired or otherwise disposed of are removed from the accounts and the resultant gain or loss is reflected in earnings.

Property and equipment consisted of the following at January 2, 2010 and January 1, 2011:

	<u>January 2, 2010</u>	<u>January 1, 2011</u>
	(in thousands)	
Land	\$ —	\$ 630
Building	—	10,680
Machinery and equipment	6,936	12,216
Computer software and equipment	14,236	22,566
Vehicles	208	173
Leasehold improvements	1,151	1,961
Furniture and fixtures	529	1,133
Construction in process	4,004	5,241
	<u>27,064</u>	<u>54,600</u>
Less accumulated depreciation and amortization	<u>(14,659)</u>	<u>(21,460)</u>
Property and equipment, net	<u>\$ 12,405</u>	<u>\$ 33,140</u>

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

At January 2, 2010 and January 1, 2011, \$0.9 million and \$2.1 million, respectively, of the Company's net property and equipment was located in the Philippines. Additionally, gross property and equipment includes \$0.3 million of equipment under capital lease arrangements and the related accumulated depreciation of \$0.2 million as of January 1, 2011. There were no capital leases as of January 2, 2010.

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:

	<u>Years</u>
Building	21
Machinery and equipment	2 – 5
Computer software (purchased and developed)	2 – 5
Computer equipment	2 – 5
Vehicles	3 – 5
Leasehold improvements*	3 – 5
Furniture and fixtures	3 – 7

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

Note 5 – Business Combination

On August 12, 2010, the Company completed the purchase (the "Acquisition") of all of the issued and outstanding shares of WAG, a leader in the automobile aftermarket performance parts and accessories market. Assets acquired include intangible assets consisting of customer relationships, technology, and trade names and furniture and fixtures, machinery and equipment, and a 350,000 square foot distribution center in LaSalle, Illinois with a headquarter office located in Chicago, Illinois. The purchase price of WAG was \$27.5 million in cash, subject to certain adjustments as set forth in that certain Stock Purchase Agreement executed August 2, 2010 (the "Purchase Agreement") among Go Fido, Inc., WAG, 2000 Riverside Capital Appreciation Fund, L.P. and the other stockholders of WAG. The Company expects that the Acquisition will provide it with product line expansion into all terrain vehicles, recreational vehicles and motorcycles, as well as deep product knowledge into niche segments like Jeep, Volkswagen and truck enthusiasts. The Company expects this expansion in the product line to increase its customer reach in the do-it-yourself automobile and off-road accessories market. In addition, WAG's state-of-the-art Midwest facility located in Illinois, which was custom built for business-to-consumer distribution of auto parts, is expected to allow the Company to complete a three-distribution center network. With this three-distribution center network, 95% of customers in the U.S. are expected to receive parts within two days of purchase using ground or common carrier. The Company believes that the combination of WAG's established brands and focus on the customer experience, coupled with the Company's capacity to compete online, will create opportunity for growth. These expected synergies from the Acquisition contributed to the goodwill associated with the Acquisition of \$7.4 million. See purchase price allocation table below for further details.

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

The purchase price was allocated based on an estimate of the fair value of assets and liabilities acquired as of the date of acquisition. The determination of estimated fair value requires management to make significant estimates and assumptions. The current allocation of the purchase price to property equipment and intangible assets acquired and goodwill is based on a preliminary valuation study. The Company has not completed its detailed analysis of prior year costs in order to assist in valuing the internet platform intellectual property. In addition, the Company has not completed its detailed analysis of prior year business development costs in order to assist in valuing the customer relationships. The Company expects to complete these evaluations by the second quarter of 2011. Any changes to the preliminary estimate used in the opening balance sheet could materially impact both the allocation of purchase price between the intangible assets and goodwill and the related amortization that has been previously recorded. The allocation of the purchase price will be adjusted to reflect the results of the final valuation study in the future. The determination of estimated fair value requires management to make significant estimates and assumptions.

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The purchase price for the Acquisition was preliminarily allocated to assets purchased and liabilities assumed as follows (in thousands):

Purchase price paid in cash (i)	\$ 27,500
Estimated purchase price adjustment (ii)	(994)
Estimated purchase price	<u>\$ 26,506</u>
Purchase price allocation is presented below:	
Assets:	
Accounts receivable	2,642
Inventory	12,366
Deferred income taxes	120
Property and equipment	16,430
Intangible assets	17,378
Other assets	2,287
Total assets	<u>\$ 51,223</u>
Liabilities:	
Accounts payable	\$(23,542)
Accrued expenses	(4,534)
Deferred income taxes	(2,734)
Other liabilities	(1,272)
Total liabilities	<u>\$(32,082)</u>
Goodwill (iii)	<u>\$ 7,365</u>
Estimated purchase price	<u>\$ 26,506</u>

- (i) Represents the purchase price paid in cash at the closing of the Acquisition of \$27.5 million.
- (ii) The estimated purchase price adjustment of \$1.0 million represents the amount that USAP believes the shareholders of WAG are obligated to pay to USAP for the negative working capital amount of WAG on the acquisition date determined in accordance with the purchase agreement for the Acquisition. The Purchase Agreement sets forth the definitions of net working capital and includes procedures for WAG and USAP to determine the working capital amount of WAG on the acquisition date. The \$1.0 million estimate is based on USAP's calculation of the working capital of WAG on the acquisition date and, upon final determination of the working capital number in accordance with the Purchase Agreement, may materially change.
- (iii) The goodwill resulting from this Acquisition is non-deductible for tax purposes.

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

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

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

WAG's financial results have been included in our consolidated statement of operations since the acquisition date of August 12, 2010. The following pro forma financial information presents the results as if the WAG acquisition had occurred at the beginning of each fiscal year presented (in thousands, except share and per share amounts):

	<u>Fifty-Two Weeks Ended</u>	
	<u>January 2, 2010</u>	<u>January 1, 2011</u>
Net sales	\$ 299,552	\$ 338,885
Net loss	(30,824)	(29,802)
Basic net loss per share	(1.03)	(0.98)
Diluted net loss per share	(1.03)	(0.98)
Weighted average shares used in computing basic net loss per common share	29,851,873	30,269,462
Weighted average shares used in computing diluted net loss per common share	29,851,873	30,269,462

During fiscal 2010, the net sales of \$39.1 million and the net loss of \$6.0 million of WAG were included in the consolidated statement of operations since the acquisition date of August 12, 2010.

Related to the Acquisition, the Company incurred acquisition and integration related costs of \$3.1 million, which were recorded in the general and administrative expenses.

Note 6 – Goodwill and Intangibles

Goodwill is tested for impairment at a level below an operating segment (also known as a component). Since our acquisition in August 2010, WAG's operations have been in the process of being integrated into the Company, and there will be no separation both operationally and financially. This integration is expected to be substantially completed during 2011. The Company determined no additional reporting unit is necessary as a result of our acquisition base on the following reasons:

- Products of both companies use the same technology;
- Both companies use the same catalogs;
- Both companies sell the same parts to customers;
- Both companies ship from the same warehouses and goes to the market in the same way; and
- Both companies are being managed under the same management.

Accordingly, the Company's single reporting segment remained consistent from the previous years. The Company performed its annual goodwill impairment testing and passed the first step of the impairment test. For the valuation under the income approach, the Company used a discount rate, which it believes reflects the risk and uncertainty related to the projected cash flows. Resulting from the Company's operating results and the continuous increase in the Company's stock price in 2010, the fair value of our reporting unit significantly exceeded its carrying value by approximately \$187 million as of October 31, 2010, our annual impairment test date, and there would have to be a 65% decrease in the fair value of the reporting unit to fail step 1. Accordingly, the second step of the impairment test was not performed. Based on the results of its annual impairment tests, the Company determined that no impairment of goodwill existed as of January 1, 2011 and January 2, 2010. During calendar year 2008, the share prices of stocks were very volatile and under considerable pressure in sustained turbulent markets. Following the deterioration in economic conditions, the Company's stock price declined to a level indicating a market capitalization below book value during the fourth quarter ended December 31, 2008. The Company performed the first step of the impairment test and noted that the carrying value of the single reporting segment exceeded its fair value. As such, the Company performed the second step of the impairment test to measure the amount of any impairment loss by comparing the implied fair value of the reporting unit to its carrying value and recorded an impairment loss of \$4.4 million as of December 31, 2008. In estimating the implied fair value of the reporting unit, we utilized the discounted cash flow method under the income approach and the guideline company and guideline transactions methods under the market approach.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the change in our goodwill during fiscal 2010 (in thousands):

Balance at December 31, 2007	\$14,201
Impairment loss on goodwill	(4,429)
Balance at December 31, 2008 and January 2, 2010	\$ 9,772
Goodwill from WAG acquisition	7,365
Balance at January 1, 2011	<u>\$17,137</u>

The accumulated impairment loss on goodwill was \$4.4 million as of January 2, 2010 and January 1, 2011.

During fiscal 2010, the Company acquired certain websites and domain names for a purchase price of \$1.0 million, of which \$843,000 was allocated to amortizable intangibles. During fiscal 2009, the Company acquired certain websites and domain names for a purchase price of \$739,000, of which \$625,000 was allocated to amortizable intangibles. The intangible assets were valued using a discounted cash flow model and the estimated useful life of the amortizable assets was determined to be five years. The Company did not note events or changes in circumstances indicating that the carrying value of the intangible assets may not be recoverable in fiscal 2010 and 2009. Therefore, no impairment loss was recognized for intangible assets as of January 1, 2011 and January 2, 2010.

During calendar year 2008, the Company recorded a non-cash impairment charge totaling \$18.4 million related to the intangibles associated with the Partsbin business, which the Company acquired in May 2006. The impairment was comprised of \$16.7 million for its websites; \$0.1 million for software; \$0.9 million for vendor agreements; and \$0.7 million for domain names. The impairment charge was primarily the result of: (i) the deterioration in the economic environment and the Company's stock price, (ii) lower sales and profitability which generated losses from certain Partsbin websites, (iii) deficiencies in the software platform also acquired from Partsbin, and (iv) the termination of volume discounts and marketing co-ops from certain vendor agreements. Given the indicators of impairment and the excess of carrying value over the undiscounted cash flows associated with these intangibles, the Company utilized a discounted cash flow approach in determining fair value for both the websites and vendor agreement intangible assets. The decrease in future cash flows from certain acquired websites and vendor agreements resulted in the long-lived assets being impaired, as the carrying value of the website assets and vendor agreement assets exceeded the fair value of those assets. Fair value is determined as the net present value of future projected cash flows. The software and domain name assets' fair value was determined using a relief from royalty approach which also resulted in a lower fair value than the carrying value.

During calendar year 2008, the Company also recorded a non-cash impairment charge totaling \$0.5 million related to the assembled workforce, which the Company acquired in April 2007. The impairment charge was primarily the result of a reduction during calendar year 2008 of the workforce originally acquired in the Philippines. The Company utilized a replacement cost approach in determining fair value which resulted in a lower fair value than the carrying value of the asset.

Intangibles subject to amortization are expensed on a straight-line basis except for the internet platform intellectual property which is amortized on an accelerated basis. Amortization expense relating to intangibles totaled \$5.0 million, \$0.7 million and \$2.8 million for calendar year 2008, fiscal 2009 and fiscal 2010, respectively.

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Intangibles, excluding goodwill, consisted of the following at January 2, 2010 and January 1, 2011 (in thousands):

	Useful Life	January 2, 2010			January 1, 2011		
		Gross Carrying Amount	Accum. Amort.	Net Carrying Amount	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount
Intangible assets subject to amortization:							
Websites	5 years	\$ 1,191	\$ (190)	\$ 1,001	\$ 2,035	\$ (594)	\$ 1,441
Software	2 - 5 years	1,040	(1,040)	—	—	—	—
Internet platform intellectual property ⁽¹⁾	10 months	—	—	—	4,300	(1,984)	2,316
Product design intellectual property ⁽¹⁾	9 years	—	—	—	2,750	(116)	2,634
Customer relationships ⁽¹⁾	4 years	—	—	—	2,050	(197)	1,853
Assembled workforce	7 years	455	(87)	368	478	(182)	296
Purchased domain names	3 years	175	(175)	—	—	—	—
Favorable lease ⁽¹⁾	2.5 years	—	—	—	78	(14)	64
Sub-Total		2,861	(1,492)	1,369	11,691	(3,087)	8,604
Intangible assets not subject to amortization:							
Domain and trade names ⁽²⁾	Indefinite life	1,745	—	1,745	10,114	—	10,114
Total		\$ 4,606	\$(1,492)	\$ 3,114	\$21,805	\$(3,087)	\$18,718

(1) Includes the intangible assets acquired in connection with the acquisition of WAG.

(2) Includes domain names of \$8.2 million purchased in connection with the acquisition of WAG.

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

2011	\$3,659
2012	1,343
2013	1,309
2014	1,089
2015	819
Thereafter	385
Total	\$8,604

Note 7 – Borrowings

At December 31, 2007, the Company had a \$7.0 million committed line of credit agreement with a bank with interest at 0.25% above the lender's reference rate maturing on October 31, 2009. There were no compensating balance requirements and substantially all the assets of the Company served as collateral on the line of credit. No amounts were outstanding on this line of credit at December 31, 2007 and 2008. The credit agreement contained customary covenants that, among other things, required compliance with certain financial ratios and targets and restricts the incurrence of additional indebtedness. The Company was compliant with all loan covenants as of December 31, 2007 and 2008. In connection with the transition of the Company's commercial banking relationship to a new bank in the fourth quarter of 2008, the line of credit was cancelled effective December 31, 2008.

As a component of the purchase price for the acquisition of Partsbin, the Company entered into promissory notes ("Notes") in the aggregate principal amount of \$5.0 million with the stockholders of Partsbin. The Notes bore interest at LIBOR and were interest only until June 2007. Beginning in the quarter ending June 30, 2007, the Notes were payable in equal quarterly installments until March 31, 2008. The Notes became due and payable upon the completion of the Company's initial public offering, as defined. The Notes were secured by substantially all the assets of the Company. During the year ended December 31, 2007 and 2008, \$4.0 million and \$1.0 million was paid on these Notes, respectively, with the proceeds from the initial public offering which occurred on February 9, 2007. There was no outstanding amount as of January 2, 2010.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On August 13, 2010, the Company executed a Loan and Security Agreement (the “Loan Agreement”) and other definitive documentation for a \$35 million secured credit facility (the “Facility”). Silicon Valley Bank (“Bank”) is the lender under the Facility. The Facility is comprised of a term loan in the original principal amount of \$25 million and a revolving line of credit with availability up to \$10 million. The Facility has a final maturity date of June 30, 2014, and borrowings under the Facility bear interest, at the election of the Company, at LIBOR (with a floor of 1.25%) plus a margin of from 2.00% to 3.00% per annum, or at the Wall Street Journal Prime Rate plus a margin of from 1.00% to 2.00% per annum, based upon the Company’s maximum funded debt ratio. An unused revolving line fee of 0.375% per annum is payable on the undrawn committed amount of the revolving line of credit. Interest on outstanding borrowings under the term loan and the revolving line of credit is payable no less than quarterly, and the outstanding principal of the term loan amortized over four years and payable quarterly, with any outstanding amount under the Facility to be paid in full on the final maturity date. Borrowings under the Facility are secured by liens over all assets of the Company, including shares of stock in each of the Company’s subsidiaries. Ten of the Company’s subsidiaries are acting as co-borrowers under the Facility.

The Loan Agreement requires the Company to comply with a number of covenants, including financial covenants related to Maximum Funded Debt to Consolidated EBITDA, Liquidity, and Consolidated Fixed Charge Coverage Ratios; negative pledge requirements; requirements to deliver quarterly and annual consolidated financial statements; requirements to maintain adequate insurances; prohibitions on changes in the business and disposition of the Company’s assets; and other customary covenants. The Loan Agreement also requires the Company to obtain a prior written consent from the Bank when the Company determines to pay any dividends on or make any distribution related to our common stock. The Loan Agreement includes usual and customary events of default and remedies for facilities of this nature. On February 28, 2011, the Company and the Bank entered into Amendment No. 1 to Loan and Security Agreement and Limited Waiver (“Amendment”). The Amendment waived the Company’s lack of compliance with the Consolidated Fixed Charge Coverage Ratio Covenant in the Loan Agreement as of January 1, 2011. The Amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA to more readily accommodate the Company’s integration of the WAG acquisition.

At January 1, 2011, the LIBOR rate and the margin were 1.25% and 3.00% per annum, respectively. The Company had no borrowings on the revolving line of credit at January 1, 2011. The remaining term loan balance was \$24 million as of January 1, 2011 and is to be repaid according to the following schedule (in thousands):

	Payments Due by Period			
Total	2011	2012	2013	2014
\$24,000	\$6,125	\$6,250	\$6,875	\$4,750

As of January 1, 2011, the Company had a capital lease obligation of \$317,000. See “*Note 13 – Commitments and Contingencies*” for further detail.

Note 8 – Share-Based Compensation and Stockholders’ Equity

The Company adopted the 2007 Omnibus Incentive Plan (the “2007 Omnibus Plan”) in January 2007, which became effective on the effective date (February 8, 2007) of the registration statement filed in connection with the Company’s initial public offering. Under the 2007 Omnibus Plan, the Company is authorized to issue 2.4 million shares of common stock under various instruments 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) 1,500,000 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 provides for automatic grant of options to purchase common stock to non-employee directors.

At January 1, 2011, 1,712,259 shares were available for future grants under the 2007 Omnibus Plan.

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the Company's stock option activity under the 2007 Omnibus Plan:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding, January 2, 2010	4,791,366	\$ 3.69	8.55	
Granted	600,000	\$ 7.37		
Exercised	(305,102)	\$ 3.39		
Expired	(104,517)	\$ 5.96		
Forfeited	(166,628)	\$ 5.32		
Options outstanding, January 1, 2011	4,815,119	\$ 4.10	7.78	\$20,802,032
Vested and expected to vest at January 1, 2011	4,581,974	\$ 4.04	7.73	\$20,072,584
Options exercisable, January 1, 2011	2,688,429	\$ 4.03	7.35	\$11,809,469

The weighted-average fair value of options granted during calendar year 2008, fiscal 2009 and fiscal 2010 was \$1.20, \$1.40 and \$3.75, 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 fiscal 2010, the total intrinsic value of the exercised options was \$1.4 million. Aggregate intrinsic value is calculated as the difference between the exercise price of underlying awards and the fair value price of the Company's common stock for options that were in-the-money as of January 1, 2011. The Company had \$3.0 million of unrecognized share-based compensation expense related to stock options outstanding as of January 1, 2011, which expense is expected to be recognized over a weighted-average period of 2.20 years.

Additional information with respect to outstanding options under the 2007 Omnibus Plan as of January 1, 2011 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Remaining Contractual Term (in years)	Weighted- Average Exercise Price	Options Exercisable	Weighted- Average Exercise Price
\$1.31-\$1.31	75,000	8.16	\$ 1.31	32,812	\$ 1.31
\$1.59-\$1.59	725,000	8.01	\$ 1.59	347,394	\$ 1.59
\$1.74-\$2.05	496,660	7.93	\$ 1.76	214,576	\$ 1.77
\$2.14-\$2.14	290,000	8.34	\$ 2.14	146,397	\$ 2.14
\$3.06-\$3.06	531,423	7.33	\$ 3.06	372,663	\$ 3.06
\$3.24-\$3.72	567,042	7.48	\$ 3.47	450,927	\$ 3.52
\$3.80-\$4.91	503,894	7.22	\$ 4.45	340,701	\$ 4.46
\$5.38-\$5.81	685,000	7.27	\$ 5.58	471,246	\$ 5.65
\$5.88-\$7.99	483,000	9.44	\$ 7.13	2,812	\$ 6.08
\$8.05-\$9.41	458,000	7.37	\$ 8.45	308,901	\$ 8.50
Totals	4,815,119	7.78	\$ 4.10	2,688,429	\$ 4.03

The Company adopted the 2007 New Employee Incentive Plan (the "2007 New Employee Plan") in October 2007. Under the 2007 New Employee Plan, the Company is authorized to issue 2.0 million shares of common stock under various instruments solely to new employees. Options granted under the 2007 New Employee Plan generally expire no later than ten years from the date of grant and generally vest over a period of four years. The exercise price of all option grants must not be less than 100% of the fair market value on the date of grant.

At January 1, 2011, 750,000 shares were available for future grants under the 2007 New Employee Plan.

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the Company's stock option activity under the 2007 New Employee Plan:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding, January 2, 2010	1,250,000	\$ 5.65	8.33	
Granted	—	—		
Exercised	—	—		
Expired	—	—		
Forfeited	—	—		
Options outstanding, January 1, 2011	1,250,000	\$ 5.65	7.32	\$3,625,000
Vested and expected to vest at January 1, 2011	1,225,536	\$ 5.72	7.30	\$3,465,874
Options exercisable, January 1, 2011	877,083	\$ 6.23	7.21	\$2,054,164

The weighted-average fair value of options granted during fiscal 2009 was \$0.51. There were no new options granted in calendar year 2008 and fiscal 2010. Aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the fair value price of the Company's common stock for options that were in-the-money as of January 1, 2011. The Company had \$ 0.3 million of unrecognized share-based compensation expense related to stock options outstanding as of January 1, 2011, which expense is expected to be recognized over a weighted-average period of 1.57 years.

Additional information with respect to outstanding options under the 2007 New Employee Plan as of January 1, 2011 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Remaining Contractual Term (in years)	Weighted- Average Exercise Price	Options Exercisable	Weighted- Average Exercise Price
\$1.15-\$1.31	500,000	8.12	\$ 1.15	283,333	\$ 1.15
\$8.65	750,000	6.78	\$ 8.65	593,750	\$ 8.65
Totals	1,250,000	7.32	\$ 5.65	877,083	\$ 6.23

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. The Board of Directors determined the value of the underlying stock by considering a number of factors, including historical and projected financial results, the risks the Company faced at the time, the preferences of the Company's Preferred Stock holders and the lack of liquidity of the Company's common stock. No stock options were granted by the Company prior to the adoption of the 2006 Plan. At January 1, 2011, there were no shares available for future grants under the 2006 Plan.

The following table summarizes the Company's stock options activity under the 2006 Plan:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding, January 2, 2010	736,128	\$ 8.26	6.46	
Granted	—	—		
Exercised	(18,000)	\$ 6.78		
Expired	(4,283)	\$ 10.30		
Forfeited	(541)	\$ 11.54		
Options outstanding, January 1, 2011	713,304	\$ 8.28	5.47	\$781,916
Vested and expected to vest at January 1, 2011	713,304	\$ 8.28	5.47	\$781,916
Options exercisable, January 1, 2011	713,304	\$ 8.28	5.47	\$781,916

There were no new options granted during calendar year 2008, fiscal 2009 and fiscal 2010.

The intrinsic value of stock options at the date of exercise is the difference between the fair value of the stock at the date of exercise and the exercise price. During fiscal 2010, the total intrinsic value of the exercised options was \$0.03 million.

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

During calendar year 2008 and fiscal 2009, there were no options exercised under this plan. Aggregate intrinsic value is calculated as the difference between the exercise price of underlying awards and the fair value price of the Company's common stock for options that were in-the-money as of January 1, 2011. The Company fully recognized share-based compensation expense related to stock options outstanding as of January 2, 2010 and January 1, 2011.

Additional information with respect to outstanding options under the 2006 Plan as of January 1, 2011 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Remaining Contractual Term (in years)	Weighted-Average Exercise Price	Options Exercisable	Weighted-Average Exercise Price
\$5.88-\$7.80	482,664	5.24	\$ 6.78	482,664	\$ 6.78
\$8.70-\$11.68	230,640	5.94	\$ 11.43	230,640	\$ 11.43
Total	713,304	5.47	\$ 8.28	731,304	\$ 8.28

Warrants

The following table summarizes the outstanding warrants at January 1, 2011:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Warrants outstanding, January 2, 2010	30,000	\$ 2.14	6.33	
Granted	20,000	\$ 8.32		
Exercised	—	\$ —		
Expired	—	\$ —		
Forfeited	—	\$ —		
Warrants outstanding, January 1, 2011	50,000	\$ 4.61	5.73	\$189,400
Vested at January 1, 2011	23,333	\$ 4.12	5.73	\$ 99,715
Options exercisable, January 1, 2011	23,333	\$ 4.12	5.73	\$ 99,715

On May 5, 2009, the Company issued warrants to purchase up to 30,000 shares of common stock, which warrants terminate seven years after their grant date. The warrants were issued in connection with the financial advisory services provided by a consultant to the Company. The warrants vest in thirty-six equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing May 5, 2009. The grant date fair value of these warrants issued on May 5, 2009 was \$1.09 per share. On April 27, 2010, the Company issued additional warrants to purchase up to 20,000 shares of common stock to the same holder in connection with the financial advisory services provided to the Company. The warrants vest in twenty-four equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing April 27, 2010. The grant date fair value of the additional warrants issued on April 27, 2010 was \$2.12 per share. The Company determined the fair value of the warrants at the date of grant using the Black-Scholes option pricing model based on the estimated fair value of the underlying common stock. No warrants were exercised in fiscal 2009 and 2010. Aggregate intrinsic value is calculated as the difference between the exercise price of underlying awards and the fair value price of the Company's common stock for warrants that were in-the-money as of January 1, 2011.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 9 – Accounting for Share-Based Compensation

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:

	December 31, 2008	January 2, 2010	January 1, 2011
Expected life	1 – 6.24 years	5.99 – 6.25 years	6 – 6.25 years
Risk-free interest rate	1% – 3%	2% – 3%	2% – 3%
Expected volatility	40% – 50%	50% – 52%	51%
Expected dividend yield	0%	0%	0%

In May 2008 and February 2009, respectively, the Board approved option grants, which contained market condition requirements. These options will vest based on the achievement of specified stock price appreciation milestones, which represents a market condition, over a five-year period commencing on May 15, 2008 and February 16, 2009. The May 2008 option grants were for 250,000 shares each. The February 2009 option grants were for 100,000 shares. The fair value of the options were estimated on the date of grant using the Monte Carlo option pricing model with the following weighted-average assumptions for each of the periods ended:

	December 31, 2008	January 2, 2010
Expected life	2 years	3.3 years
Risk-free interest rate	3.01%	1.87%
Expected volatility	41%	50%
Expected dividend yield	0%	0%
Initial stock price	\$ 3.72	\$ 1.15

Share-Based Compensation Expense

The Company recognized share-based compensation expense of \$2.9 million, \$3.3 million and \$2.7 million, net of \$287,000, \$245,000 and \$186,000 of expense capitalized as internally-developed software, for each of calendar year 2008, fiscal 2009 and fiscal 2010, respectively. The Company has recognized an income tax benefit of \$1.1 million, \$1.2 million for calendar year 2008 and fiscal 2009, respectively. No tax benefit was recognized for fiscal 2010 due to the valuation allowance position.

Under ASC 718, forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Our estimated forfeiture rate was calculated based on actual historical forfeitures experienced under our equity plans. In the fourth quarter of fiscal 2010, the Company performed its periodic review of the estimated forfeiture rate during the last fifty-two weeks and noted no significant forfeitures which would change the estimated forfeiture rate from the previous year. Therefore, the weighted-average forfeiture rate from 10% to 18% was used as consistent with the prior year.

There was \$3.3 million of unrecognized compensation expense related to stock options and warrants as of January 1, 2011, which expense is expected to be recognized over a weighted-average period of 2.11 years. The table below sets forth the expected amortization of share-based compensation expense for the next three years for all options granted as of January 1, 2011, assuming all employees remain employed by the Company for their remaining vesting periods:

	Fifty-Two Weeks Ending		
	Dec. 31, 2011	Dec. 29, 2012	Dec. 28, 2013
Amortization of share-based compensation	\$1,885	\$ 957	\$ 551

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 10 – Net Income (Loss) Per Share

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

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
(in thousands, except share and per share data)			
<i>Net (Loss) Income Per Share</i>			
Numerator:			
Net (loss) income	\$ (16,906)	\$ 1,317	\$ (13,926)
Denominator:			
Weighted-average common shares outstanding (basic)	29,846,757	29,851,873	30,269,462
Common equivalent shares from common stock options and warrants	—	957,238	—
Weighted-average common shares outstanding (diluted)	29,846,757	30,809,111	30,269,462
Basic net (loss) income per share	\$ (0.57)	\$ 0.04	\$ (0.46)
Diluted net income (loss) per share	<u>\$ (0.57)</u>	<u>\$ 0.04</u>	<u>\$ (0.46)</u>

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

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
Common stock warrants	84,332	—	12,033
Options to purchase common stock	<u>5,669,661</u>	<u>6,777,494</u>	<u>1,508,289</u>
Total	<u>5,753,993</u>	<u>6,777,494</u>	<u>1,520,232</u>

Additionally, due to the loss in calendar year 2008 and fiscal 2010, 115,211 and 1,700,550 shares, respectively, have been excluded from the computation of diluted net income (loss) per share.

Note 11 – Income Taxes

As discussed in "Note 1- Summary of Significant Accounting Policies and Nature of Operations", the Company adopted new accounting principles on accounting for uncertain tax positions in calendar year 2008. The new principles 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.

During calendar year 2008, the Company was audited by the Internal Revenue Service for the years ended December 31, 2006 and 2007. The audit was concluded with the payment of a non-material sum. During fiscal 2010, the Company was audited by the Internal Revenue Service for the year ended December 31, 2008. The audit was concluded with no change. The tax years 2006-2009 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company does not anticipate a significant change to the amount of unrecognized tax benefits within the next twelve months.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The components of income (loss) before income taxes consist of the following:

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
		(in thousands)	
Domestic operations	\$(28,713)	\$ 3,795	\$ (2,540)
Foreign operations	(15)	645	832
Total income (loss) before income taxes	<u>\$(28,728)</u>	<u>\$ 4,440</u>	<u>\$ (1,708)</u>

Income tax (benefit) expense for calendar year 2008, fiscal 2009 and fiscal 2010 consists of the following:

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010	52 Weeks Ended January 1, 2011
		(in thousands)	
Current:			
Federal tax	\$ (50)	\$ (774)	\$ (434)
State tax	(121)	193	8
Foreign tax	52	56	73
Total current taxes	<u>(119)</u>	<u>(525)</u>	<u>(354)</u>
Deferred:			
Federal tax	(9,097)	2,568	61
State tax	(2,606)	1,080	13
Foreign tax	—	—	—
Total deferred taxes	<u>(11,703)</u>	<u>3,648</u>	<u>74</u>
Valuation allowance	—	—	12,498
Income tax (benefit) expense, consolidated	<u>\$(11,822)</u>	<u>\$ 3,123</u>	<u>\$12,218</u>

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Income tax (benefit) expense differs from the amount that would result from applying the federal statutory rate as follows:

	Year Ended December 31, 2008	52 Weeks Ended January 2, 2010 (in thousands)	52 Weeks Ended January 1, 2011
Income tax at U.S. federal statutory rate	\$ (9,768)	\$ 1,511	\$ (581)
Share-based compensation	161	1,086	(93)
State income tax, net of federal tax effect	(1,880)	729	(759)
Tax exempt interest	(220)	(16)	(8)
Foreign tax	60	(163)	(210)
Non deductible acquisition costs	—	—	258
Other	(175)	(24)	1
Change in valuation allowance	—	—	13,610
Effective tax (benefit) provision	<u>\$(11,822)</u>	<u>\$ 3,123</u>	<u>\$ 12,218</u>

The Company's effective tax rate was impacted by income taxes incurred in foreign and state jurisdictions. With respect to the income of its foreign subsidiaries, the Company takes the position that the earnings of the foreign subsidiaries are permanently invested in that jurisdiction. Additionally, the foreign subsidiaries are currently in a cumulative deficit earnings and profits position for tax purposes. As a result, no additional income taxes have been provided on the possible repatriation of these earnings to the parent company. The favorable impact of foreign taxes is due in large part to a tax holiday in the Philippines, which is effective through September 2011. The term of the tax holiday is four years, provided as an incentive for new business and no further requirements exist to maintain the tax holiday. The impact of this tax holiday decreased foreign taxes by \$0, \$136,000 and \$182,000 for calendar year 2008, fiscal 2009 and fiscal 2010, respectively. The benefit of the tax holiday on net income per share (diluted) was immaterial for the related years.

For calendar year 2008, fiscal 2009 and fiscal 2010, the effective tax rate for the Company was 41.36%, 70.33% and (715.28)%, respectively. The Company's effective tax rate for calendar year 2008 differs from the U.S. federal statutory rate primarily as a result of state income taxes and other non-deductible permanent differences. The Company's effective tax rate for fiscal 2009 differs from the U.S. federal statutory rate primarily as a result of state income taxes and other non-deductible permanent differences including stock option forfeitures with a tax effected value of \$1.1 million as described below. The Company's effective tax rate for fiscal 2010 differs from the U.S. federal statutory rate primarily as a result of the recording of a \$13.6 million valuation allowance against the Company's deferred tax assets.

During the review of the Company's income tax provision for the thirteen weeks ended April 4, 2009, we noted that deferred tax assets for permanent differences created by vested non-qualified stock option forfeitures had not been properly reduced in accordance with ASC 740. We have evaluated the effects of this misstatement on prior period's consolidated financial statements in accordance with the guidance provided by ASC 250-10 *Accounting Changes and Error Corrections*, and concluded that no prior period financial statements are materially misstated. We also evaluated the effect of correcting this misstatement on our interim and annual results of operations for the respective quarters ended September 30, 2007 through the thirteen weeks ended April 4, 2009.

The total impact of the quarterly adjustments related to the balance sheet is summarized as follows:

(in thousands)	Three Months Ended,						Thirteen Weeks Ended
	Sept. 30, 2007	Dec. 31, 2007	Mar. 31, 2008	June 30, 2008	Sept. 30, 2008	Dec. 31 2008	April 4, 2009
Deferred Tax Asset	\$ (93)	\$ (181)	\$ (80)	\$ (38)	\$ (147)	\$ (40)	\$ (579)
Total Assets as Reported	\$109,606	\$110,056	\$109,778	\$98,636	\$94,516	\$90,430	\$93,545
Adjusted Total Assets	\$109,513	\$109,875	\$109,698	\$98,598	\$94,369	\$90,390	\$92,966
Effect on Total Assets	(0.1%)	(0.2%)	(0.1%)	(0.0%)	(0.2%)	(0.0%)	(0.6%)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The total impact of the quarterly adjustments to the income statement is summarized as follows:

<i>(in thousands)</i>	Three Months Ended,						Thirteen Weeks Ended
	Sept. 30, 2007	Dec. 31, 2007	Mar. 31, 2008	June 30, 2008	Sept. 30, 2008	Dec. 31 2008	April 4, 2009
Tax Provision	\$ 93	\$ 181	\$ 80	\$ 38	\$ 147	\$ 40	\$ 579
Net Income (loss) as Reported	\$ 893	\$(5,498)	\$ (875)	\$(12,063)	\$ (491)	\$(3,477)	\$ (100)
Effect on Net Income (loss)	(10.4%)	3.3%	9.1%	0.3%	29.9%	1.2%	579%
Effect on EPS	\$ 0.00	\$ 0.006	\$ 0.00	\$ 0.00	\$0.005	\$ 0.00	\$0.019

Considering both quantitative and qualitative measures, we determined that the judgment of a reasonable person relying upon the financial statements would not have been changed or influenced by the inclusion or correction of these items in the respective quarters or in the thirteen weeks ended April 4, 2009. We determined that the misstatements are immaterial to the financial statements as of December 31, 2007 and 2008 and for each of the respective quarters of those years. However, we concluded that the impact of recording the cumulative effect of these periods may be material. As permitted by ASC 250-10, we used the iron curtain approach to quantify the misstatement. The iron curtain approach assumes that because the prior year financial statements were not materially misstated, correcting any immaterial errors that existed in those statements in the current year is the correct accounting. Therefore, we recorded the cumulative adjustment during the thirteen weeks ended April 4, 2009 by decreasing deferred tax assets and increasing current income tax expense.

Deferred tax assets and deferred tax liabilities at December 31, 2008, January 2, 2010 and January 1, 2011 consisted of the following:

	December 31, 2008	January 2, 2010 <i>(in thousands)</i>	January 1, 2011
Deferred tax assets:			
Inventory and inventory related reserve	\$ 592	\$ 642	\$ 1,712
Share-based compensation	1,941	2,109	3,218
Amortization	12,535	10,856	12,517
Sales and bad debt allowances	310	422	689
Vacation accrual	119	191	284
Other comprehensive income	60	33	34
Net operating loss and AMT credit carry-forwards	1,361	88	4,169
Other	—	257	322
Total deferred tax assets	16,918	14,598	22,945
Valuation Allowance	—	—	(18,335)
Net deferred tax assets	16,918	14,598	4,610
Deferred tax liability:			
Tax over book depreciation	762	2,100	1,582
Tax over book amortization	—	—	5,289
Other	—	—	426
Total deferred tax liability	762	2,100	7,297
Net deferred tax assets (liabilities)	\$ 16,156	\$ 12,498	\$ (2,687)

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

At January 1, 2011, federal and state net operating loss (NOL) carryforwards were \$6.8 million and \$27.5 million respectively. Federal NOL carryforwards of \$2.7 million were acquired in the acquisition of WAG which are subject to Internal Revenue Code section 382 and limited to an annual usage limitation of \$135,000. Additionally, a tax benefit of \$0.9 million related to the federal and state NOL carryforwards that were created by the exercise of stock options will be credited to additional paid in capital once realized as a reduction of income taxes payable. Federal NOL carryforwards expire in 2029 and 2030, while state NOL carryforwards begin to expire in 2016. The state NOL carryforwards expire in the respective tax years as follows:

2016 - 2022	\$24,916
2023 - 2030	<u>2,553</u>
	<u>\$27,469</u>

The valuation allowance for deferred tax assets recorded during fiscal 2010 is based on a more likely than not threshold. The ability to realize deferred tax assets depends on the ability to generate sufficient taxable income within the carryback or carryforward periods provided for in the tax law for each applicable tax jurisdiction. We considered the following possible sources of taxable income when assessing the realization of deferred tax assets:

- Future reversals of existing taxable temporary differences;
- Future taxable income exclusive of reversing temporary differences and carryforwards;
- Taxable income in prior carryback years; and
- Tax-planning strategies.

The assessment regarding whether a valuation allowance is required or should be adjusted also considers, among other matters, the nature, frequency and severity of recent losses of the combined USAP and WAG operations, forecasts of future profitability, the duration of statutory carryforward periods, our experience with tax attributes expiring unused and tax planning alternatives. In making such judgments, significant weight is given to evidence that can be objectively verified.

Concluding that a valuation allowance is not required is difficult when there is significant negative evidence that is objective and verifiable, such as cumulative losses in recent years. Although we expect that the operations of the recently acquired WAG business and our ability to achieve future profitability of these operations was enhanced by the cost reductions that occurred as a result of the acquisition and subsequent integration efforts, WAG's historic operating results remain relevant as they are reflective of the industry and the effect of economic conditions. The fundamental businesses and inherent risks in which the WAG business operates did not change from those which existed prior to the acquisition. We utilized a three-year analysis of actual results as the primary measure of cumulative losses in recent years. However, because a substantial portion of those cumulative losses relate to impairment of intangible assets and goodwill, those three-year cumulative results are adjusted for the effect of these items. In addition, the near- and medium-term financial outlook is considered when assessing the need for a valuation allowance.

The valuation of deferred tax assets requires judgment and assessment of the future tax consequences of events that have been recorded in the financial statements or in the tax returns, and our future profitability represents our best estimate of those future events. Changes in our current estimates, due to unanticipated events or otherwise, could have a material effect on our financial condition and results of operations. Prior to the acquisition of WAG, the Company concluded that it was more likely than not that we would realize the deferred tax assets in all jurisdictions. However, with the acquisition of WAG, based largely on the weight of the combined cumulative three-year adjusted loss position, it was determined that it was not more likely than not that the Company would realize its net deferred tax assets as of January 2, 2011. Therefore, a valuation allowance of \$18.3 million was recorded as of January 1, 2011, of which \$4.7 million was recorded against the acquired deferred tax assets of WAG as of our acquisition date of August 12, 2010.

If, in the future, we generate taxable income on a sustained basis in jurisdictions where we have recorded full valuation allowances, our conclusion regarding the need for full valuation allowances in these tax jurisdictions could change, resulting in the reversal of some or all of the valuation allowances. If our operations generate taxable income prior to reaching profitability on a sustained basis, we would reverse a portion of the valuation allowance related to the corresponding realized tax benefit for that period, without changing our conclusions on the need for a full valuation allowance against the remaining net deferred tax assets.

Included in accrued expenses are income taxes payable of \$24,000, \$39,000 and \$95,000 for calendar year 2008, fiscal 2009 and fiscal 2010, respectively, consisting primarily of foreign taxes.

Note 12 – Related-Party Transactions

Beginning in November 2003, the Company leased its corporate headquarters and primary warehouse from Nia Chloe, LLC ("Nia Chloe"), a member of which, Sol Khazani, is one of our board members. Another Nia Chloe member, Mehran Nia, was also one of our board members until his resignation in December 2009. Lease payments and expenses associated with this related party arrangement totaled \$548,000, \$535,000, and \$389,000, respectively, for the years ended

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2008, January 2, 2010, and January 1, 2011. The Company has evaluated its relationship with Nia Chloe with regard to ASC 810 *Consolidation* (“ASC 810”) (formerly referenced as FIN 46R, “*Consolidation of Variable Interest Entities*”). The Company has determined that Nia Chloe does not meet the criteria for consolidation under ASC 810 and therefore this entity is not consolidated in the Company’s financial statements.

From time to time, the Company purchased inventory from an entity that was partially owned until 2009 by a member of the Company’s Board of Directors. During the years ended December 31, 2008 and January 2, 2010, the Company purchased inventory totaling \$242,000 and \$330,000 respectively, from the entity, which the Company believes to be at fair market value.

Since October 2006, the Company has purchased paid search engine marketing services from an entity of which a member of the Company’s Board of Directors served as CEO until 2008 and chairman until mid-2009. During the years ended December 31, 2008 and January 2, 2010, the Company purchased paid search engine marketing services totaling \$281,000, and \$225,000, respectively, from the entity, which the Company believes to be at fair market value.

In September 2008, the Company entered into a verbal agreement with a member of the Company’s Board of Directors, Mehran Nia, to provide consulting services. The arrangement could be terminated by either party at anytime, and the director was paid \$10,000 per month. Mr. Nia resigned from the Board of Directors in December 2009. For the year ended January 2, 2010 and the year ended January 1, 2011, the total consulting fees paid were \$120,000 and \$10,000 respectively, to the individual. The arrangement was terminated as of January 2, 2010, and the final payment made to settle the account as of that date.

The Company has entered into indemnification agreements with the Company’s directors and executive officers. These agreements require the Company to indemnify these individuals to the fullest extent permitted under law against liabilities that may arise by reason of their service to the Company, and to advance expenses incurred as a result of any proceeding against them as to which they could be indemnified. The Company also intends to enter into indemnification agreements with the Company’s future directors and executive officers.

Note 13 – Commitments and Contingencies

The Company’s primary warehouse facilities are under a lease which commenced in November 2003, expired in December 2008, was month-to-month until February 1, 2010 when an extension of the lease incorporating a reduction in rent through January 31, 2011 was signed, and continues on a month-to-month basis.

In September 2004, the Company entered into a lease to house the Company’s corporate headquarters and for warehouse space adjacent to its primary facility in Carson, California from a related party under an agreement that expired August 31, 2006. This lease was renewed through February 28, 2009 and is currently month-to-month. On October 1, 2006, the Company entered into a third lease agreement for additional warehouse space adjacent to its primary facilities in Carson, CA. This lease expired May 31, 2009, was month-to-month until February 1, 2010 when an extension of the lease incorporating a reduction in rent through January 31, 2011 was signed, and continues on a month-to-month basis.

In January 2010, the Company’s Philippines subsidiary entered into a new lease agreement that will accommodate the Company’s Philippines workforce into one (1) office building from its previous offices in Pasig and Makati; the leases for the Pasig and Makati facilities were terminated in July and October 2010, respectively. Under the terms of the lease agreement, the Company added approximately 39,665 square feet of space for a period of 63 months, effective March 1, 2010. Monthly rental fee of approximately \$25,000 is subject to 5% annual escalation beginning on the 3rd year of the lease term and renewable for a sixty (60)-month term upon mutual agreement of both parties. In December 2008, the Company entered into a five-year operating lease for warehouse space in Chesapeake, Virginia, which commenced in January 2009 and expires in December 2013. Under the terms of the lease, the Company added approximately 72,500 square feet of space for initial monthly rent of approximately \$15,000 with annual rent escalations. Additionally, the Company has one option to extend the terms for an additional five years on or before June 30, 2013 and one option to terminate the lease effective December 31, 2011 with six months prior written notice.

Upon our acquisition of WAG, we assumed a lease related to their office and warehouse space (60,845 square feet) in Independence, Ohio which was originally executed on January 1, 2003 and amended on October 3, 2003 and February 1, 2008. The lease expires on January 31, 2013, with two five-year renewal options. Commencing on February 1, 2008, the rent is \$0.2 million per year, payable in equal monthly installments of \$0.02 million on the first day of each month during the initial term.

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Also, upon our acquisition of WAG, we assumed a sublease related to their headquarter office (22,323 square feet) in Chicago, Illinois which was originally executed on December 4, 2007. The term of the lease commenced on May 14, 2008 and will expire on January 13, 2017. The annual base rent for the initial lease term through January 31, 2009 is \$0.3 million with an annual escalation of \$0.1 million commencing from February 1, 2009 through the remaining lease term.

Facility rent expense, inclusive of amounts paid to Nia Chloe, for the years ended December 31, 2008, January 2, 2010 and January 1, 2011, was \$1.6 million, \$1.9 million and \$2.4 million, respectively.

Future minimum facility lease payments required under the above operating leases as of January 1, 2011 are \$1,482,000, \$1514,000, \$1,369,000, \$719,000, \$541,000 and \$379,000 for 2011 to 2015 and thereafter, respectively.

Capital lease commitments at January 1, 2011 were as follows:

	(in thousands)			
	2011	2012	2013	Total
Capital lease commitments	196	109	27	332
Less: interest payments	(12)	(3)	—	(15)
Capital lease obligations	184	106	27	317

There were no capital leases as of January 2, 2010.

Legal Matters

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the potential loss, if any, cannot be reasonably estimated. However, 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 with the exception of the items noted below. 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.

Parts Geek Litigation

On June 25, 2009, the Company filed suit in the United States District Court for the Central District of California against Parts Geek LLC, certain of its members and employees for misappropriation of trade secrets, breach of contract and unfair competition and requesting monetary damages and injunctive relief, and Parts Geek filed an answer on August 12, 2009. On January 27, 2010, the complaint was amended to include claims for copyright infringement and to add an additional party. Parts Geek filed an answer and counterclaims to the amended complaint on February 22, 2010. Each party filed a motion for summary judgment requesting that the Court rule on all claims made in this matter without sending the matter to a jury. On June 7, 2010, the Court ruled on all claims in the matter, denying the Company's claims against Parts Geek and Lucas Thomason and denying Parts Geek's claims against the Company. The judge additionally denied Parts Geek's counterclaims against the Company. Parts Geek and Lucas Thomason petitioned the Court to order the Company to pay their legal fees and costs, the Court ordered the Company to do so and on August 11, 2010 all parties stipulated that approximately \$1.1 million of legal fees and costs would be owed to Parts Geek and Lucas Thomason should the Company lose its appeal or win its appeal and lose in trial. A bond has been posted to guarantee payment of \$1.1 million plus interest, at a cost of approximately \$0.02 million to the Company. The Company is not required to pay the fees and costs at this time; they would be due if the Company loses its appeal and determines to not appeal beyond the 9th Circuit Court of Appeals, or if the Company wins on appeal but loses at trial once the case is remanded to the trial court and, in accordance with ASC 450-20 *Loss Contingencies* ("ASC 450-20"), the Company has not accrued for these fees and costs. The Company filed an appeal and filed its initial brief on January 21, 2011. The reply brief is due March 21, 2011. The Company has analyzed this matter in accordance with ASC 450-20 and, in accordance with the definition of probable loss described therein, we have concluded that no accrual is necessary at this time.

California Air Resources Board Inquiry

The Company received an inquiry by the California Air Resources Board ("CARB") into sales of non-California compliant catalytic converters in the state of California via our stock-ship and drop-ship network. On March 4, 2010, and again on June 16, 2010, the Company met with CARB to discuss alleged sales of catalytic converters into California by the Company and third-party suppliers that are not compliant with California regulations. CARB informed the Company that penalties shall be assessed with regard to any non-compliant sales; discussions are ongoing, and due to a number of variables, any penalties are not estimable at this time. This will impact sale of products for emissions systems to the state and may

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

adversely impact our sales and operating results. The Company is unable to assess the amount of the final monetary cost in this regard, other than legal fees that have been and may continue to be incurred in preparing responses and defending the Company in the inquiry and that there will be an associated cost for penalties in this matter.

Asbestos

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

Note 14 – Employee Retirement 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 \$147,000, \$154,000 and \$213,000 for calendar year 2008, fiscal 2009 and fiscal 2010, 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 USAP. Liabilities under the 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 January 1, 2011, the assets and associated liabilities of the Deferred Compensation Plan were \$261,000 and \$224,000, respectively, and are included in other non-current assets and non-current liabilities, respectively, in our consolidated balance sheets. The associated liabilities mainly include the employee contributions of \$175,000 and the employer contributions of \$34,000 made as of January 1, 2011. Included in other income, the Company recorded a gain of \$11,000 for the change in the cash surrender value of the Company-owned life insurance policies during fiscal 2010.

[Table of Contents](#)

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 15 – Quarterly Information (Unaudited)

The following quarterly information includes all adjustments which management considers necessary for a fair presentation of such information. For interim quarterly financial statements, the provision for income taxes is estimated using the best available information for projected results for the entire year. The sum of the four quarters will not agree to the year total due to rounding within a quarter.

	Thirteen Weeks Ended				Thirteen Weeks Ended			
	April 4, 2009	July 4, 2009	Oct. 3, 2009	Jan 2, 2010	April 3, 2010	July 3, 2010	Oct. 2, 2010	Jan 1, 2011
(in thousands, except share and per share data)								
Consolidated Statement of Income Data:								
Net sales	\$ 39,664	\$ 43,805	\$ 47,043	\$ 45,776	\$ 56,291	\$ 53,188	\$ 72,349	\$ 80,450
Gross profit	14,640	15,868	16,899	16,467	19,807	18,397	24,007	27,399
Income (loss) from operations	593	1,072	1,328	1,256	2,475	658	(1,980)	(2,580)
Income (loss) before income taxes	684	1,098	1,385	1,273	2,497	687	(2,060)	(2,832)
Net (loss) income	\$ (679)	\$ 629	\$ 781	\$ 585	\$ 1,547	\$ 462	\$ (13,039)	\$ (2,896)
Adjustment:								
Tax benefit (provision)(1)	8							
Adjusted net (loss) income (1)	\$ (671)	\$ 629	\$ 781	\$ 585	\$ 1,547	\$ 462	\$ (13,039)	\$ (2,896)
Basic net (loss) income per share as reported and adjusted (1)	\$ (0.02)	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.05	\$ 0.02	\$ (0.43)	\$ (0.10)
Diluted net (loss) income per share as reported and adjusted (1)	\$ (0.02)	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.05	\$ 0.01	\$ (0.43)	\$ (0.10)
Shares used in computation of basic net (loss) income per share as reported and adjusted	29,846,757	29,846,757	29,848,694	29,865,452	30,003,117	30,314,478	30,357,988	30,402,264
Shares used in computation of diluted net (loss) income per share as reported and adjusted	29,846,757	30,395,189	31,004,035	31,147,869	31,425,002	31,994,447	30,357,988	30,402,264

(1) Includes immaterial adjustments recorded for all quarters of calendar year 2008 during the thirteen-weeks ended April 4, 2009. See Note 11 – Income Taxes for further information.

Note 16 – Subsequent Events

February 28, 2011, the Company and its lender, Silicon Valley Bank (“Bank”), entered into Amendment No. 1 to Loan and Security Agreement and Limited Waiver (“Amendment”). The Amendment waived the Company’s lack of compliance with the Consolidated Fixed Charge Coverage Ratio Covenant in the Loan and Security Agreement entered into by and between the Company and Bank on August 13, 2010 (“LSA”). The Amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA to more readily accommodate the Company’s integration of the WAG acquisition.

Table of Contents

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
2.1*	Acquisition Agreement dated May 19, 2006 by and among U.S. Auto Parts Network, Inc. and Partsbin, Inc., on the one hand, and The Partsbin.com, Inc., All OEM Parts, Inc., Power Host, Inc., Auto Parts Web Solutions, Inc., Web Chat Solutions, Inc., Everything Internet, LLC, Richard E. Pine, Lowell E. Mann, Brian Tinari and Todd Daugherty, on the other hand
2.2	Stock Purchase Agreement executed August 2, 2010 among the Acquisition Sub, WAG, Riverside and the other stockholders of WAG (incorporated by reference to Exhibit 10.57 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 4, 2010)
3.1	Second Amended and Restated Certificate of Incorporation of U.S. Auto Parts Network, Inc. as filed with the Delaware Secretary of State on February 14, 2007 (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007)
3.2	Amended and Restated Bylaws of U.S. Auto Parts Network, Inc. (incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007)
4.1*	Specimen common stock certificate
10.1+*	U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan
10.2+*	Form of Stock Option Agreement under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.
10.3+*	Form of Notice of Grant of Stock Option under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.
10.4+*	Form of Acceleration Addendum to Stock Option Agreement under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.
10.5+*	U.S. Auto Parts Network, Inc. 2007 Omnibus Plan and forms of agreements
10.8+*	Offer Letter of Employment dated May 19, 2006 by and between U.S. Auto Parts Network, Inc. and Richard Pine
10.9+*	Non-Competition Agreement dated May 19, 2006 by and among U.S. Auto Parts Network, Inc. and Richard Pine, Lowell Mann, Brian Tinari and Todd Daugherty
10.10*	Shareholder's Release dated May 19, 2006 by and between U.S. Auto Parts Network, Inc. and Richard Pine
10.23*	Commercial Lease Agreement dated January 1, 2004 by and between U.S. Auto Parts Network, Inc. and Nia Chloe Enterprises, LLC, amended effective February 1, 2010
10.24*	Standard Industrial/Commercial Multi-Tenant Lease — Gross dated October 1, 2006 by and between U.S. Auto Parts Network, Inc. and Margay 2003, LLC, amended effective February 1, 2010
10.25*	Standard Industrial/Commercial Multi-Tenant Lease — Gross dated July 12, 2004 by and between U.S. Auto Parts Network, Inc. and Isadore Socransky, amended effective February 1, 2010
10.26*	Lease dated November 30, 2004 by and between U.S. Auto Parts Network, Inc. and William Coats
10.27†*	Catalog License and Parts Purchase Agreement† dated November 20, 2006 by and between U.S. Auto Parts Network, Inc. and WORLDPAC, Inc.
10.29†*	Services Agreement dated October 3, 2006 by and between U.S. Auto Parts Network, Inc. and Efficient Frontier, Inc.
10.32+*	Offer Letter of Employment dated January 1, 2006 by and between U.S. Auto Parts Network, Inc. and Houman Akhavan
10.33+	Form of Indemnification Agreement for Officers and Directors (incorporated by reference to Exhibit 10.33 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2010)
10.35*	Deeds of Assignment and Declarations of Trust executed September 2006 regarding MBS Tek Corporation stock transfer

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
10.36	Purchase Agreement, dated April 20, 2007, by and among U.S. Auto Parts Network, Inc., Access Worldwide Communications, Inc. and their respective Philippine affiliates (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2007)
10.37	Lease Agreements, dated August 8, 2007, by and among MBS Tek Corporation and Roshan Commercial Corp. (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 2, 2007)
10.38	Form of Suppliers' Agreement entered into between U.S. Auto Parts Network, Inc. and certain of its U.S. based suppliers and primary drop-ship vendors (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 2, 2007)
10.39+	Employment Agreement dated March 29, 2010 between U.S. Auto Parts Network, Inc. and Shane Evangelist (incorporated by reference to Exhibit 10.39 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2010)
10.40+	Non-Qualified Stock Option Agreement dated October 15, 2007 between U.S. Auto Parts Network, Inc. and Shane Evangelist (incorporated by reference to Exhibit 99.3 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 17, 2007)
10.41+	Non-Qualified Stock Option Agreement dated October 15, 2007 (performance grant) between U.S. Auto Parts Network, Inc. and Shane Evangelist (incorporated by reference to Exhibit 99.4 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 17, 2007)
10.42+	2007 New Employee Incentive Plan (incorporated by reference to Exhibit 99.5 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 17, 2007)
10.43	Lease Agreement, dated October 11, 2007, by and between MBS Tek Corporation and Averon Holding Corporation (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 14, 2007)
10.44+	Employment Agreement, dated March 29, 2010, between the Company and Aaron Coleman (incorporated by reference to Exhibit 10.44 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2010)
10.45	Support Continuity Agreement, dated April 28, 2008, between the Company and Alexander Adegan (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 28, 2008)
10.46	Consulting Agreement, dated April 28, 2008, among the Company, uParts.com, Inc. and Alexander Adegan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 28, 2008)
10.47+	Non-Incentive Stock Option Agreement, dated April 28, 2008, between the Company and Alexander Adegan (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 28, 2008)
10.48+	Non-Qualified Stock Option Agreement, dated May 15, 2008, by and between the Company and Shane Evangelist (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 15, 2008)
10.49	Stipulation of settlement in the matter entitled: In re U.S. Auto Parts Network, Inc. Securities Litigation, Case No. CV 07-2030-GW (JC) (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 6, 2008)

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
10.50+	Separation Agreement and Release of Claims, dated December 9, 2008, between the Company and Michael J. McClane (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 9, 2008)
10.51	Consulting Agreement, dated December 9, 2008, between the Company and Michael J. McClane (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 9, 2008)
10.52+	Employment Agreement, dated March 29, 2010 between the Company and Theodore Sanders (incorporated by reference to Exhibit 10.53 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2010)
10.53+	Non-Qualified Stock Option Agreement, dated February 16, 2009, between the Company and Theodore Sanders (incorporated by reference to Exhibit 10.63 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on February 17, 2009)
10.54+	Non-Qualified Stock Option Agreement (performance grant), dated February 16, 2009, between the Company and Theodore Sanders (incorporated by reference to Exhibit 10.64 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on February 17, 2009)
10.55	Commercial Lease Agreement dated December 16, 2008 by and between U.S. Auto Parts Network, Inc. and Ashley Indian River, LLC (incorporated by reference to Exhibit 10.66 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 26, 2009)
10.56	Commercial lease dated January 7, 2010 by and between U.S. Autoparts Network Philippines Corporation and Robinsons Land Corporation (incorporated by reference to Exhibit 10.56 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2010)
10.58	Guarantee executed August 2, 2010 by the Company (incorporated by reference to Exhibit 10.58 to the Company's Current Report on Form 8-K filed with Securities and Exchange Commission on August 4, 2010)
10.59	Loan and Security Agreement, dated August 13, 2010, between Bank, USAPN, ASAP, Go Fido Inc., Parts Bin, Lobo, Whitney, Value, Private Label, Pacific, AutoMD, and Local Body Shops (incorporated by reference to Exhibit 10.59 to the Company's Quarterly Report on Form 10-Q filed with the Securities Exchange and Commission on August 17, 2010)
10.63+	2011 Base Salaries and Target Bonuses of certain officers (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 9, 2010)
10.64	Sublease dated December 4, 2007 by and between Marketing Werks, Inc. and J.C. Whitney & Co.
10.65	Second Amendment To Lease Agreement dated February 1, 2008 by and between JCM Management LLC and Stylin' Concepts Corp.
10.66	Amendment No. 1 to Loan and Security Agreement and Limited Waiver, dated February 28, 2011, by and among Silicon Valley Bank and USAPN, ASAP, Go Fido Inc., Parts Bin, Lobo, Whitney, Value, Private Label, Pacific, AutoMD, and Local Body Shops (incorporated by reference to Exhibit 10.70 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 4, 2011)
16.1	June 21, 2010 Letter from E&Y to the SEC (incorporated herein by reference to the Company's Current Report on Form 8-K filed with the SEC on June 23, 2010)
21.1	Subsidiaries of U.S. Auto Parts Network, Inc.
23.1	Consent of Independent Registered Public Accounting Firm
23.2	Consent of Independent Registered Public Accounting Firm

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of the principal executive officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the principal financial officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

+ Indicates a management contract or compensatory plan or arrangement

† U.S. Auto Parts Network, Inc. has been granted confidential treatment with respect to certain portions of this exhibit (indicated by asterisks), which have been separately filed with the Securities and Exchange Commission.

SUBLEASE

THIS SUBLEASE (this "Sublease") is made as of this 4th day of December, 2007 between **Marketing Werks, Inc.**, an Illinois corporation ("Sublessor"), whose address is 111 E. Wacker Drive, Ste 3000, Chicago, Illinois 60601, and **J.C. Whitney & Co.**, a Delaware corporation, ("Sublessee"), whose address is 225 North Michigan Avenue, Chicago, IL 60601.

1. **Premises.** Sublessor, in consideration of the rents to be paid and the terms and conditions to be performed by Sublessee, does hereby sublease to Sublessee, those certain premises situated in Chicago, Illinois, more particularly described as Suite 3000, containing approximately 22,323 rentable square feet (the "Premises"), located on the 30th floor of the building located at 111 E. Wacker Drive, Chicago, Illinois 60601 (the "Building"), together with the right to use the common facilities of the Building.

2. **Term.** The term of this Sublease shall be for a period commencing on May 14, 2008 (the "Commencement Date") and shall expire on January 31, 2017 (the "Expiration Date"). On or before May 14, 2008 Sublessor shall deliver possession of the Premises to Sublessee (i) free and clear of all occupants, (ii) with all personal property removed other than the Furniture, and (iii) in reasonably clean condition (the "Delivery Condition"). In the event Sublessor fails to deliver the Premises to Sublessee in the Delivery Condition on or before the Commencement Date, subject to Sublessee's rights and remedies available to Sublessee in this Sublease, at law or in equity, the Commencement Date shall be postponed until such time as Sublessor delivers the Premises to Sublessee in the Delivery Condition.

- a) In the event Sublessor does not deliver the Premises to Sublessee on or before May 21, 2008 in the Delivery Condition, Sublessor acknowledges that such delay will result in Sublessee having to hold over in their existing premises under their sublease agreement (the "Midas Sublease") with Midas International Corporation ("Midas") at 225 North Michigan Avenue. Therefore, without limiting Sublessee's other rights or remedies under this Sublease, at law or in equity, including Sublessee's right to receive Delay Damages, Sublessor will pay, indemnify and defend Sublessee from and against all claims and damages, including, but not limited to, direct, consequential and special damages, sustained by reason of Sublessor's failure to deliver the premises by May 21, 2008 (the "Holdover Damages"). The Holdover Damages include, but are not limited to, holdover rent and any damages payable by Sublessee to Midas or any other party. Sublessor acknowledges that the prime landlord under the Midas Sublease ("Midas Landlord") has the right to extend the term of Midas' tenancy for a period of one (1) year at two hundred percent (200%) of the then gross rent in the last year of the lease for 73,456 rentable square feet as a result of any holdover. If Midas Landlord exercises such right, not including any other damages that may be payable by Sublessee, the annual gross rent cost payable to Midas Landlord will be approximately \$5,000,000. Sublessee shall have the right to offset any such Holdover Damages for which Sublessor is responsible against rent

payable pursuant to this Sublease. In such case, Sublessor shall have the right, but not the obligation to negotiate a settlement with Midas Landlord and Sublessee shall reasonably cooperate with Sublessor in any such negotiation (at no cost to Sublessee), provided that any such settlement agreement shall be subject to Sublessee's reasonable approval and in no event shall such settlement agreement adversely affect Sublessee's obligations or rights under the Midas Sublease or with respect to Midas Landlord.

- b) In addition, and without limiting Sublessee's other rights or remedies under this Sublease, at law or in equity, including Sublessee's right to receive Holdover Damages, if Sublessor does not deliver the Premises to Sublessee on or before May 14, 2008 in the Delivery Condition, Sublessor shall pay to Sublessee as liquidated damages for such delay (but not to compensate Sublessee for Holdover Damages), and not as a penalty, the amount of \$2,000 per day ("Delay Damages") for each day of such delay through the actual delivery date. Sublessor shall pay all such accrued Delay Damages to Sublessee on a weekly basis as such Delay Damages accrue. The payment of Delay Damages shall not affect Sublessor's obligation to also pay Holdover Damages, if applicable, and any other amounts payable to Sublessee by Sublessor. If Sublessor fails to pay the Delay Damages when required, Sublessee shall have the right to offset such Delay Damages against rent payable under this Sublease.
- c) In addition, and without limiting Sublessee's other rights or remedies, including Sublessee's right to receive Holdover Damages and Delay Damages or any other right or remedy under this Sublease, at law or in equity, if Sublessor does not deliver the Premises to Sublessee on or before June 15, 2008, Sublessee shall have the right to terminate this Sublease at no cost whatsoever to Sublessee, provided such notice is delivered before delivery of the Premises to Sublessee in the Delivery Condition.

3. **Rent.**

- a) Sublessee shall pay to the Sublessor as base rent for the Premises during the term of this Sublease, payable in advance, the monthly installments listed below (the "Base Rent"), on or before the twenty-fifth day of each and every month preceding the month such rent is due, commencing with the Commencement Date; provided, however, that if the term shall commence on a day other than the first day of a calendar month or shall end on a day other than the last day of a calendar month, the rental for such first or last fractional month shall be such proportion of the monthly rental as the number of days in such fractional month bears to the total number of days in the calendar month, provided further, that if Sublessee shall occupy the Premises prior to the Commencement Date, such occupancy shall be subject to all of the terms and conditions of this Sublease, but Sublessee shall not be required to pay Base Rent or Additional Rent until the Commencement Date:

Commencement Date – January 31, 2009:	\$25,113.38/month
February 1, 2009 – January 31, 2010:	\$26,043.50/month
February 1, 2010 – January 31, 2011:	\$26,973.63/month
February 1, 2011 – January 31, 2012:	\$27,903.75/month
February 1, 2012 – January 31, 2013:	\$28,833.88/month
February 1, 2013 – January 31, 2014:	\$29,764.00/month
February 1, 2014 – January 31, 2015:	\$30,694.13/month
February 1, 2015 – January 31, 2016:	\$31,624.25/month
February 1, 2016 – January 31, 2017:	\$32,554.38/month

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- b) Sublessee shall pay Sublessor Base Rent, plus any additional Operating Expenses incurred by Sublessor, rent adjustments, rent adjustment deposits, or other sums charged for the Premises pursuant to the terms of the Amended Master Lease (as defined in Section 6 below) (therein referred to as "Additional Rent") at the address set forth for Sublessor below, or at such other place as Sublessor shall designate from time to time:

Marketing Werks, Inc.
111 E. Wacker Drive, Ste 3000
Chicago, Illinois 60601
Attention: Julie Guida

First month's rent shall be due within five (5) days after Sublessee, Sublessor and Master Landlord have executed and delivered the Master Landlord's Consent (as defined in Section 17) to this Sublease. Notwithstanding the foregoing, provided Sublessee is not in Default hereunder or under the Amended Master Lease, gross Rent (inclusive of Additional Rent) shall abate from the Commencement Date through November 30, 2008 (the "Abatement Period"). For the avoidance of doubt, provided Sublessee is not in Default hereunder or under the Amended Master Lease, Sublessee shall not be required to pay Base Rent or Additional Rent from the Commencement Date through November 30, 2008. If the Commencement Date does not occur on May 14, 2008 (unless due to Sublessee), the Abatement Period shall be extended one day for each day that the Commencement Date is delayed beyond May 14, 2008.

- c) Additional Rent shall be payable in the same manner as provided in the Amended Master Lease and shall be based on Master Landlord's statements, including estimates rendered to Sublessor with respect to such items, which statements shall be made available by Sublessor to Sublessee promptly after receipt thereof from Master Landlord. To the extent that any amounts paid by Sublessee on account of any of such items are based

on estimates provided by Master Landlord and exceed the amount actually due and payable by Sublessee hereunder, such overpayment shall, in accordance with the procedure by which overpayment of such an item is treated under the Amended Master Lease, be either refunded to Sublessee or credited against the amounts next coming due from the Sublessee for the applicable item pursuant to this Section promptly after Sublessor has received the refund or credit from Master Landlord; provided, however, that if such overpayment shall have been credited to Sublessee and is not fully reimbursed by such credit prior to the expiration of this Sublease term, then promptly following the expiration or earlier termination of the term of this Sublease, Sublessor shall reimburse Sublessee for the remaining balance of such overpayment, less any amounts Sublessee may owe to Sublessor upon the expiration of the term of this Sublease. To the extent that any estimated amounts so paid by Sublessee are less than the amount actually due and payable hereunder by Sublessee, Sublessee shall pay the difference to Sublessor within twenty (20) days after notice thereof. If any refund or credit results from an audit, challenge or other proceeding instituted by Sublessor, Sublessor shall be entitled to first deduct from any such refund or credit Sublessor's actual reasonable expenses incurred in connection with obtaining such refund or credit and Sublessee shall be entitled to the net refund or credit within twenty (20) days after receipt by Sublessor either, at Sublessor's option, as a credit against Rent next due and payable or in the form of a reimbursement payment to Sublessee. Sublessee's payments under this Section for any partial lease year shall be prorated on a per diem basis. At Sublessee's request, Sublessor shall exercise its audit rights (at no cost to Sublessor) under the Amended Master Lease to the extent that such rights are available under the Amended Master Lease and shall share such information with Sublessee. In no event shall Sublessee's obligation to pay Additional Rent hereunder exceed the amount attributable to the Premises due and payable by the Sublessor under the Amended Master Lease. Sublessee shall be entitled to the portion of all credits if any, given by Master Landlord to Sublessor for overpayment of such costs that are attributable to the Premises during the term of this Sublease. The provisions of this Section shall survive the expiration or sooner termination of this Sublease.

4. **Security Deposit.** Sublessee shall pay Sublessor the amount of **One Hundred Fifty-three Thousand Four Hundred Seventy and 62/100 (\$153,470.62)** Dollars (equal to three months' gross rent), within five (5) days after Sublessor, Sublessee and Master Landlord have executed and delivered the Master Landlord's Consent (as defined in Section 17) to this Sublease, as security deposit for Sublessee's faithful performance of Sublessor's obligations hereunder. If Sublessee fails to pay rent or otherwise defaults with respect to any provision of this Sublease, Sublessor may, after the expiration of all applicable notice and cure periods, use, apply or retain all or any portion of the deposit for the payment of any rent or any other sum to which Sublessor may become obligated by reason of Sublessee's default, or to compensate Sublessor for any loss or damage which Sublessor may suffer thereby. Sublessee shall not be

required to keep the deposit separate from its general account. If Sublessee performs all of Sublessor's obligations hereunder, the deposit, or so much thereof as has not theretofore been applied by Sublessor or refunded to Sublessee, shall be returned, without payment of interest or other increments for its use, to Sublessee within 30 days after the expiration of the term hereof and after Sublessee has vacated the Premises. Notwithstanding the foregoing, provided that Sublessee is not then in Default and no event which with the passage of time or the giving of notice or both would constitute a Default exists, the Security Deposit shall be reduced to two months' gross rent (the "Reduced Security Deposit Amount") on and as of February 1, 2014 (the "Security Deposit Reduction Date"). Accordingly, if Sublessee is not in Default as of February 14, 2014 and no event which with the passage of time or the giving of notice or both would constitute a Default exists, Sublessor shall refund the excess Security Deposit within thirty (30) days after February 14, 2008. Notwithstanding the foregoing, if Sublessee is in Default on the Security Deposit Reduction Date or Sublessee is in breach of this Sublease but the applicable notice and cure period has not expired by such date, then upon Sublessee's cure of any such Default or breach, Sublessee shall have the right to reduce the Security Deposit to the Reduced Security Deposit Amount, provided that if Sublessee has been in Default more than three (3) times during the Term prior to the Security Deposit Reduction Date then Sublessee shall not have the right to reduce the Security Deposit after Security Deposit Reduction Date regardless if Sublessee ultimately cures such Default or breach.

Instead of a cash security deposit, Sublessee shall have the right at any time during the Sublease Term (including, without limitation, on or before the date that the cash Security Deposit is due hereunder) to replace the cash Security Deposit with a clean, unconditional and irrevocable Letter of Credit Security Deposit (the "Letter of Credit"). If Sublessee elects to deposit a Letter of Credit, the Letter of Credit and any substitute Letter of Credit shall be issued in a form and by a bank (the "Bank") approved by Sublessor, in Sublessor's reasonable discretion. Upon Sublessee's deposit of the Letter of Credit with Sublessor, Sublessor shall immediately return the cash Security Deposit. Sublessee shall maintain the Letter of Credit, or a substitute Letter of Credit, from the Bank approved by Sublessor, in accordance with the terms hereof, in full force and effect at all times during the entire term of this Sublease (subject to terms of this Sublease) and for a period of thirty (30) days thereafter (the last day of such 30 day period shall be referred to as the "Return Date") or until all obligations due from Sublessee under this Sublease have been paid in full. If the Letter of Credit expires before the Return Date, Sublessee shall replace the Letter of Credit deposited with Sublessor by providing Sublessor with a substitute Letter of Credit at least thirty (30) days prior to the expiration date of the then effective Letter of Credit being held by Sublessor in the amount required hereunder. Sublessor shall have the right to draw upon the Letter of Credit and apply such Letter of Credit or portion thereof to cure any Default of Sublessee under this Sublease in same manner described in this Section 4. Within thirty days following the expiration or earlier termination of this Sublease, Sublessor shall return the Letter of Credit, or so much thereof as shall not have theretofore been applied in accordance with the terms of this paragraph or drawn upon by Sublessor and applied to cure any default of Sublessee existing at the expiration or earlier termination of this Sublease. If the Security Deposit is in the form of a Letter of Credit when the Security Deposit is reduced on February 14, 2014 as described above, Sublessee shall have the right to replace the existing Letter of Credit with a new Letter of Credit in the required amount. Upon such replacement Sublessor shall return the Letter of Credit previously in Sublessor's possession.

5. **Assignment/Subletting.** Sublessee may not assign this Sublease in whole or in part or sublet the Premises, without the prior written consent of the Sublessor, which consent shall not be unreasonably withheld, conditioned or delayed, and Master Landlord to the extent Master Landlord's consent is required. If permitted under the terms of the Amended Master Lease, Sublessor's consent shall not be required for an assignment or sublease of all or any portion of the Premises to (i) any entity resulting from a merger of consolidation with Sublessee or any organization purchasing substantially all of Sublessee's assets, (ii) any entity succeeding to substantially all the business and assets of Sublessee, (iii) any subsidiary, affiliate or parent of Sublessee, (iv) any entity controlling, controlled by or under common control with Sublessee, or (v) any entity resulting from the reorganization of Sublessee outside of bankruptcy organization. However, no such assignment or subletting shall relieve Sublessee of its obligations hereunder.

6. **Master Lease.**

- a) This Sublease shall be subordinate to the Lease dated as of February 24, 2005 between **PARKWAY REALTY SERVICES, LLC**, a Delaware limited liability company as successor to Lincoln-Carlyle Illinois Center, L.L.C., a Delaware limited liability company, as landlord ("Master Landlord"), and Sublessor, as tenant (the "Master Lease"), as amended by the First Amendment to Office Lease dated May 17, 2006 (the "First Amendment" and together with the Master Lease, the "Amended Master Lease"), copies of which are attached hereto and incorporated herein as Exhibit A.
- b) Except as set forth in this Sublease and except for the following sections of the Amended Master Lease which are excluded from this Sublease:

Section 3 – Rent;
Section 29 – SECURITY DEPOSIT;
Section 35 – OPTION TO EXTEND LEASE;
Section 36 – RIGHT OF FIRST OFFER;
Section 2 of the First Amendment (Landlord's Work);
Section 3(b) of the First Amendment (BASE RENT); and
Section 6(i) of the First Amendment (Early Option to Terminate)

the obligations of Sublessor and Sublessee to each other, and the terms, conditions and provisions of this Sublease shall be deemed to be those set forth in the Amended Master Lease, and for such purposes, the terms "Landlord", "Tenant" and "Lease" as used in the Amended Master Lease shall be deemed to mean Sublessor, Sublessee, and Sublease respectively. In the event of any conflict between this Sublease and the Amended Master Lease, the terms, conditions and provisions of this Sublease shall prevail. In particular, the Sublessee will be responsible for all operating costs and tax escalations that may be passed through under the Amended Master Lease relating to the period after the Commencement Date.

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- c) During the term of this Sublease, Sublessee does hereby expressly assume and agree to perform each and every obligation of Sublessor under the Amended Master Lease pertaining to the Premises; except for (i) payment of Base Rent (defined in the Amended Master Lease) and, except as otherwise provided herein, Additional Rent (defined in the Amended Master Lease), (ii) except for the posting of a security deposit (other than as required pursuant to this Sublease), (iii) any obligations accruing before Commencement Date, and (iv) any obligation arising due to the acts or omissions of Sublessor. Sublessee shall hold Sublessor free and harmless of and from all liability, judgment, costs, damages, claims or demands, including attorney fees arising out of Sublessee's failure to comply with or perform Sublessee's obligations as described in this Sublease.
- d) Sublessor will perform all of the obligations of the tenant pursuant to the Amended Master Lease, except those undertaken by Sublessee pursuant to this Sublease.
- e) If Master Landlord fails to perform any of the provisions set forth in the Amended Master Lease to be performed by Master Landlord, Sublessor shall upon written request of Sublessee use reasonable efforts in seeking to obtain the performance of Master Landlord pursuant to the Amended Master Lease. In addition, Sublessee shall have the right to take any action against Master Landlord in its own name and for that purpose, and only to such extent, Sublessor grants to Sublessee the rights of Sublessor with respect to the Premises, retaining a concurrent right to enforce such rights. If any such action against Master Landlord in Sublessee's name is barred by reason of lack of privity, non-assignability or otherwise, Sublessor shall permit Sublessee to take such action or otherwise exercise its rights under this Sublease in Sublessor's name; provided, however, that Sublessee shall indemnify and hold Sublessor harmless against all liability, loss or damage which Sublessor may incur or suffer by reason of any such action, and that Sublessee provides to Sublessor copies of all papers and notices of all proceedings so Sublessor may be kept informed in respect thereof. Sublessor shall execute any documents reasonably required to permit Sublessee to take any such action in Sublessor's name. Sublessee shall not receive any abatement of rent under this Sublease because of the Master Landlord's failure to perform any of its obligations under the Master Lease, except that if Sublessor receives an abatement of rent from the Master Landlord relating to the Premises which arises pursuant to Master Landlord's obligations under the Amended Master Lease, Sublessee shall receive a corresponding abatement of rent hereunder.
- f) If Sublessor receives an abatement of rent from Master Landlord relating to the Premises which arises pursuant to Master Landlord's obligations under the Amended Master Lease, Sublessee shall receive a corresponding abatement of rent hereunder.

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- g) Sublessor shall use reasonable efforts to obtain for Sublessee the benefit of all rights granted to Sublessor, as tenant under the Amended Master Lease, with respect to the Premises in order to effectuate the intent of the parties and the purpose of this Sublease.
 - h) Sublessor and Sublessee each promptly shall furnish to the other copies of any notices of default given by Master Landlord.
 - i) Sublessor will not consent (i) to a termination of the Amended Master Lease that will be effective on or before the earlier of (a) the termination of this Sublease or (b) the Expiration Date (for reasons other than casualty or condemnation as expressly permitted under the Amended Master Lease), or (ii) to an amendment of the Amended Master Lease without the consent of the Sublessee, which consent shall not be unreasonably withheld, delayed or conditioned. Furthermore, neither Sublessor nor its agents, employees or contractors will cause a default to occur under the Amended Master Lease and shall take all actions reasonably necessary to preserve the Amended Master Lease.
 - j) All notice requirements and grace periods as set forth in the Amended Master Lease for defaults thereunder shall be applicable to defaults hereunder, except as otherwise set forth herein.

This Sublease shall be treated for all purposes as a commercial lease and not as a consumer lease.

7. Option to Terminate.

- a) Sublessor shall not exercise the option to terminate the Amended Master Lease set forth in Section 37 of the Master Lease (as amended by the First Amendment); provided, however, Sublessor shall have the right to terminate the Amended Master Lease effective as of January 31, 2014 in accordance with the terms of the Amended Master Lease if Sublessee exercises Sublessee's termination option set forth in this Section 7.
- b) Sublessee shall have the option to terminate this Sublease effective January 31, 2014 with prior written notice delivered to Sublessor on or before December 1, 2012, together with payment of \$258,708.30, and the balance of \$258,708.30 delivered to Sublessor on or before December 1, 2013. Sublessee specifically shall not have the option to terminate as set forth in Section 6 (i) of the First Amendment. Sublessee shall have no obligation whatsoever to pay the "Termination Payment" (as defined in the Amended Master Lease) to Master Landlord.

8. **Alterations.** Sublessee agrees it will make no alterations to the Premises without the written consent of Sublessor, which shall not be unreasonably withheld, conditioned or delayed, and Master Landlord (if consent is required under the Amended Master Lease); provided, however, if Master Landlord's consent is not required under the Amended Master

Lease for alterations, Sublessee shall not be required to obtain Sublessor's consent for such alterations. Sublessor shall use all reasonable efforts to assist Sublessee in obtaining Master Landlord's consent. Upon written approval, any work approved shall be performed according to all applicable building and fire codes and Sublessee shall be responsible for obtaining all governmental approvals.

9. **Care of Premises.** Throughout the term of this Sublease, Sublessee agrees to keep and maintain the Premises in good and sanitary order, and repair and in accordance with the requirements of the Amended Master Lease (excepting those services and repairs, if any, which Master Landlord must perform pursuant to the Amended Master Lease), and shall on the last day of the term hereof, surrender the Premises to Sublessor in substantially as good condition as when received, normal wear and tear and damage by fire or other casualty excepted. Under no circumstances shall Sublessee be required to remove any improvements located in the Premises as of the Commencement Date (the "Existing Improvements"). To the extent the Amended Master Lease requires the removal of such Existing Improvements, Sublessor shall be required to remove the Existing Improvements. However, Sublessee shall remove its personal property and any improvements or alterations made by Sublessee to the extent required under the Amended Master Lease or by Master Landlord.

10. **Notices.** All notices which may be required to be given under this Sublease or the Amended Master Lease shall be in writing. All notices shall be served either personally or sent by United States certified or registered mail, postage prepaid, return receipt requested, or by prepaid nationally recognized overnight courier service, and addressed to the following addressees or to such other addresses as the parties may designate.

If to Sublessor: Marketing Werks, Inc.
111 E. Wacker Drive, Ste 3000
Chicago, Illinois 60601
Attn: Julie Guida

With a copy to: McCormick Braun Friman, LLC
217 N. Jefferson, 1st Floor
Chicago, IL 60661
Attn: Michael S. Friman, Esq.

If to Sublessee: J.C. Whitney & Co.
225 N. Michigan Avenue, Suite 1000
Chicago, Illinois 60601
Attention: Jerome Mascitti

If to Landlord: Parkway Realty Service, LLC
111 East Wacker Dr
Suite 1220
Chicago, IL 60601
Attention: Vice President-Asset Management

Notices given hereunder shall be deemed to have been given on the date of personal delivery (or the first business day thereafter if delivered on a non-business day) or three (3) days after the date of certified mailing or the next business day after being sent by overnight courier.

11. **Additional Conditions.** Subject to Sublessor's obligation to deliver the Premises to Sublessee in the Delivery Condition, Sublessor's representations contained herein, and latent defects, Sublessee acknowledges that it has had sufficient opportunity to inspect the Premises and is satisfied with the condition thereof and accepts Premises in "as is" condition with all faults.

12. **Indemnity and Insurance**

- a) Sublessee agrees to defend, indemnify and hold Sublessor and Sublessor's officers, directors, partners, employees, agents and invitees harmless from and against any and all loss, cost, expense and liability whatsoever (including Sublessor's cost of defending against the foregoing, such cost to include reasonable attorneys' fees) resulting or occurring by reason of the acts or failures to act of Sublessee or otherwise resulting or occurring from Sublessee's use or occupancy of the Premises or any violation caused, suffered or permitted by Sublessee, its agents, contractors, servants, licensees, employees or invitees, provided that the foregoing indemnity shall not include any cost or damage to the extent caused by the gross negligence or willful misconduct of the Sublessor or the breach of this Sublease by Sublessor.
- b) Sublessor shall not be liable (i) for any damage to Sublessee's or the Sublessor's property located in the Premises or any injury to any person, regardless of the cause of such damage or injury except to the extent caused by the gross negligence or willful misconduct of the Sublessor, nor (ii) for any acts or omissions of other tenants of the Building or other persons in the Building, nor (iii) for any condition of the Premises whatsoever (except to the extent Sublessor breaches any material representations contained herein relating to the condition of the Premises). Sublessee hereby releases Sublessor and Sublessor's officers, directors, employees, agents and invitees from all liability and expense relating to any of the foregoing.
- c) Sublessee shall comply with those provisions of the Amended Master Lease pertaining to insurance, as such provisions apply to the Premises. All such policies shall name Sublessor and Master Landlord as additional insured parties (to the extent required under the Amended Master Lease).
- d) Sublessor shall and hereby does indemnify and hold Sublessee harmless from and against any and all actions, claims, demands, damages, liabilities and expenses (including, without limitation, reasonable attorneys' fees) asserted against, imposed upon or incurred by Sublessee by reason of (a) the existence of Hazardous Substances in, under and about the Premises

(as defined in the Amended Master Lease) as of the date possession of the Premises is delivered to Sublessee, (b) the gross negligence or willful misconduct of Sublessor or any of its agents, contractors, servants, licensees, employees or invitees, and (c) any violation caused, suffered or permitted by Sublessor, its agents, contractors, servants, licensees, employees or invitees of any of the provisions of this Sublease, provided that the foregoing indemnity shall not include any cost or damage to the extent caused by the negligence or willful misconduct of the Sublessee or the breach of this Sublease by Sublessee.

13. **Brokers.** Sublessor and Sublessee covenant, warrant and represent that the sole brokers instrumental in consummating this Sublease, were **CB Richard Ellis, Inc. and Studley, Inc.**, whose charges and commissions shall be paid by Sublessor. Sublessee and Sublessor agree to defend, indemnify, and hold the other party harmless against any claims for brokerage commission arising out of any conversations or negotiations or claims of other brokers where such claims are based on the alleged acts of the other party.

14. **Sublessor's Improvements; Furniture.**

- a) Except as provided herein, Sublessee acknowledges and agrees that it is leasing the Premises on an "AS IS" basis and there is no written or implied obligation upon Sublessor or Master Landlord with respect to any improvement, redecoration or other alteration of the Premises or any part of the Building. All representations contained in the Amended Master Lease with respect to the improvement, redecoration or other alteration of the Premises shall not apply to this Sublease.
- b) On the Commencement Date, the Sublessee shall purchase from Sublessor for the sum of \$1.00 and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, all of the furniture noted on Exhibit B attached hereto in the Premises ("Furniture"). The Furniture includes, without limitation, the Sublessor's phone system, corresponding phone equipment and wiring located in the Premises as of the date hereof. The Furniture shall be conveyed to Sublessee by Bill of Sale, free and clear of all liens and encumbrances (with a warranty by Sublessor that as of the date of such delivery, Sublessor has good title to and the right and authority to so deliver the Furniture and permit Sublessee's use thereof during the Sublease Term). All personal property not deemed to be Furniture shall be removed by Sublessor at Sublessor's cost from the Premises before the Commencement Date. The Sublessee shall be responsible for all costs associated with the phones and phone switch including, without limitation, maintenance of the phone switch, local phone lines and the connection of such and all long distance costs. The Sublessee shall be responsible for all personal property taxes levied on the Furniture. Except as expressly provided above, the Sublessee acknowledges and agrees that it has inspected the Furniture and agrees that the Sublessee is accepting the Furniture on an "As Is" basis and the

Sublessor makes no representation as to the condition or adequacy of such furniture for the Sublessee's needs. Sublessee acknowledges and agrees that the Furniture may be subject to normal wear, tear and obsolescence accruing after the date hereof and that the quality and quantity of such Furniture may differ on the Commencement Date from the descriptions set forth on Exhibit B. Other than a material decrease in the quantity or quality of furniture listed, in no event may the quality or quantity of Furniture delivered on the Commencement Date be the basis for a default by Sublessor hereunder or entitle Sublessee to any remuneration credit or offsets for such difference. For purposes of this Section, with respect to chairs a "material decrease" in the quantity of the furniture shall mean a decrease of ten or more chairs. Notwithstanding the foregoing, if Sublessee claims a material decrease, and if such material decrease would constitute a breach of Sublessor's obligations hereunder, then Sublessor shall have the right to cure by providing substitute furniture or a credit for same, in Sublessor's sole discretion, within 30 days after the Commencement Date. If Sublessee elects not to acquire Sublessor's phone system (such election to be made within fifteen (15) days after the date hereof), (i) Sublessor shall remove the phone system and the corresponding phone equipment prior to the Commencement Date, and (ii) the Abatement Period will be extended by one (1) month.

- c) At the expiry or earlier termination of the term of this Sublease, the Sublessee shall, at its sole cost, surrender the Premises to the Sublessor in the same condition as such are as of the Commencement Date, reasonable wear and tear excepted. The Sublessee shall pay to the Sublessor the cost of all repairs and replacements required to the Premises as a result of the Sublessee's use thereof beyond normal wear and tear.

15. **Signs.** Sublessor will allow, and will request Master Landlord's consent to allow, Sublessee to utilize, during the Sublease Term, all signage rights granted to Sublessor under the Amended Master Lease. Sublessor will request Master Landlord's consent to allow Sublessee to install and maintain a building standard suite entry sign identifying Sublessee at the entrance to the Premises, provided that Sublessee shall pay all costs and expenses to install, maintain and remove such signage. The Sublessee shall be responsible for the cost of removal of all such signage and make good of the area affected by the placing of such signage at the end of the term of this Sublease.

16. **Holding Over.** If Sublessee remains in possession of the Premises after expiration or termination of the term of this Sublease, without the Sublessor's and the Landlord's consent, Sublessee shall become a tenant-at-sufferance, and there shall be no renewal of this Sublease by operation of law. Sublessee agrees to defend, indemnify and hold Sublessor harmless from and against any and all loss, rental charges, costs, expense and liability whatsoever (including Sublessor's cost of defending against the foregoing, such cost to include reasonable attorneys' fees) resulting or occurring by reason of such overholding of the Premises. The inclusion of the preceding sentence in this Sublease shall not be construed as Sublessor's consent to Sublessee's holding over.

17. **Landlord's Consent.** This Sublease is subject to and conditioned upon the consent of Master Landlord. Following the execution of this Sublease by Sublessee, Sublessee will keep open Sublessee's offer to enter into this Sublease for a period of thirty (30) days ("Consent Period") days while Sublessor uses reasonable efforts to obtain Master Landlord's consent ("Master Landlord's Consent"). Master Landlord's Consent shall be subject to Sublessee's approval, which shall not be unreasonably withheld, delayed or conditioned, and Sublessee's time for consideration of Master Landlord's Consent shall extend the Consent Period on a day for day basis; provided, however, regardless of the amount of time for Sublessee's consideration and negotiation of Master Landlord's Consent in no event shall the Consent Period exceed forty five (45) days provided that Sublessee is considering and negotiating Master Landlord's Consent reasonably, timely and in good faith. In the event that Master Landlord's Consent is not obtained within the Consent Period, and Sublessor is not able to procure Master Landlord's Consent within five (5) additional days thereafter, either party may thereafter cancel this Sublease by written notice to the other given at any time prior to delivery of Master Landlord's Consent, in which event any amounts paid by Sublessee to Sublessor shall be promptly refunded to Sublessee. Sublessor shall pay all costs, fees and charges required by the Amended Master Lease to be paid to Master Landlord in connection with any consent of Master Landlord to this Sublease, not to exceed the amount set forth in the Amended Master Lease.

18. **Sublessor's Representations & Warranties.** Sublessor hereby represents and warrants that:

- a) Attached hereto as Exhibit A is a true, correct and complete copy of the Amended Master Lease, to Sublessor's knowledge, there are no understandings relating to the Premises which will adversely affect or diminish the rights of Sublessee or impose any greater obligations on Sublessee than is expressly stated therein and there are no additional agreements between Sublessor and Master Landlord with respect to the Premises;
- b) The Amended Master Lease is in full force and effect;
- c) Sublessor has no knowledge of and has received no notice from Master Landlord of default by Sublessor under the Amended Master Lease which default remains uncured on the date hereof;
- d) Neither Sublessor nor to Sublessor's knowledge, Master Landlord, is now in default under the Amended Master Lease, nor to Sublessor's knowledge does there presently exist any circumstances which with the giving of notice or the passage of time would be a default under the Amended Master Lease;
- e) The heating, ventilation and air conditioning systems and other building systems serving the Premises are in good working order and will continue to be at the delivery of the Premises to Sublessee;

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- f) The electrical systems and communication cabling serving the Premises are in good working order and will continue to be at the delivery of the Sublease Premises to Sublessee
 - g) Sublessor has not received any notices from Master Landlord of any material defects, deficiencies or violations with respect to the Premises that have not been substantially corrected;
 - h) To the best of Sublessor's knowledge, there are no hazardous materials in the Premises which do not comply with applicable laws; and
 - i) Sublessor has not assigned the Amended Master Lease or sublet any portion of the Premises (except pursuant to this Sublease).

19. **Remedies.** The occurrence of any one or more of the following events shall constitute a default and breach of this Sublease by Sublessor: (a) Sublessor's failure to do, observe, keep and perform any of the terms, covenants, conditions, agreements or provisions of this Sublease required to be done, observed, kept or performed by Sublessor, within thirty (30) days after written notice by Sublessee to Sublessor of said failure (except when the nature of Sublessor's obligation is such that more than thirty (30) days are required for its performance, then Sublessor shall not be deemed in default if it commences performance within the thirty (30) day period and thereafter diligently pursues the cure to completion); or (b) the failure of any material representation or warranty to be true when deemed given hereunder. Notwithstanding the foregoing, in the event of an emergency (including, without limitation, the risk that the Amended Master Lease may terminate), Sublessee may give Sublessor such shorter notice as is practicable under the circumstances. In the event of a default by Sublessor (after the expiration of applicable notice and cure periods), Sublessee, at its option, without further notice or demand, shall have the right to any one or more of the following remedies in addition to all other rights and remedies provided at law or in equity or elsewhere herein: (a) to remedy such default or breach (such remedy may include, without limitation, paying any amounts owed by Sublessor under the Amended Master Lease) and seek reimbursement for same (provided that if Sublessee pays to Master Landlord any amounts owed by Sublessor under the Master Lease, Sublessee shall have the right to deduct such payments from the installments of Base Rent and Additional Rent next falling due until Sublessee is reimbursed in full); or (b) to pursue the remedy of specific performance. Nothing herein contained shall relieve Sublessor from its obligations hereunder, nor shall this Section be construed to obligate Sublessee to perform Sublessor's obligations.

20. **Casualty; Eminent Domain.** In the event of a fire or other casualty affecting the Building or the Premises, or of a taking of all or a part of the Building or the Premises under the power of eminent domain, except as set forth in the Amended Master Lease: (i) Sublessor shall not have any obligation to repair or restore the Premises or any alterations or personal property; (ii) Sublessee shall be entitled only to a proportionate abatement of minimum rent to the extent Sublessor receives a corresponding abatement of rent under the Amended Master Lease during the time and to the extent the Premises are unfit for occupancy for the purposes permitted under this Sublease and not occupied by Sublessee as a result thereof; (iii) Sublessee shall not, by reason thereof, have a right to terminate this Sublease unless Sublessor has the corresponding

right to terminate the Amended Master Lease in such circumstance or unless the Amended Master Lease shall be otherwise terminated; and (iv) Sublessor reserves the right to terminate the Amended Master Lease and this Sublease in connection with any right granted to it under the Amended Master Lease for an event of casualty or eminent domain whether or not the Premises is damaged or the subject of a taking. In the event Master Landlord or Sublessor exercises the right to terminate the Amended Master Lease as the result of any such fire, casualty or taking, (a) Sublessor shall provide Sublessee with a copy of the relevant termination notice and this Sublease shall terminate on the date upon which the Amended Master Lease terminates and (b) Sublessee shall immediately pay to Sublessor all of Sublessee's insurance proceeds relating to all alterations that Sublessor is obligated to pay to Master Landlord (but not the proceeds to the Furniture or Sublessee's other personal property). Sublessee shall be entitled to all proceeds or claims for eminent domain that the Sublessor is entitled to as tenant under the Amended Master Lease.

21. **Quiet Enjoyment.** Sublessee, on paying the rent and performing all the terms, covenants and conditions of this Sublease, shall and may peacefully and quietly have, hold and enjoy the Premises for the Sublease Term, free from any act or hindrance by Sublessor or any party claiming by, through or under Sublessor.

22. **Early Access.** Sublessee shall have the right to access the Premises by May 1, 2008 in order that Sublessee may do work required by Sublessee to make the Premises ready for Sublessee's use and occupancy, including, without limitation, install Sublessee's phone and data system. Sublessee shall use reasonable efforts to not materially interfere with Sublessor's business operations during such early access period. Any such early entry into and occupation of the Premises by Sublessee shall be deemed to be under all of the terms, covenants, conditions and provisions of this Sublease, excluding the covenant to pay rent.

23. **General Provisions.**

- a) **Entire Agreement; Amendments.** This Sublease constitutes the entire agreement between the parties concerning the matters set forth herein. Neither Sublessee nor Sublessor shall be bound by any terms statements, conditions or representations, oral or written, express or implied, not contained in this Sublease. No modification of this Sublease shall be binding or valid unless expressed in a writing executed by Sublessor and Sublessee.
- b) **Successors and Assigns.** This Sublease shall be binding upon and inure to the benefit of the parties and their respective successors, permitted assigns, heirs and legal representatives.
- c) **Interpretation.** The Exhibits attached to this Sublease are part of this Sublease. Section and subsection headings are for conveniences only, and not for use in interpreting this Sublease. If a court finds any provision of this Sublease unenforceable, all other provisions shall remain enforceable, and such unenforceable provision shall be deemed severed from this Sublease.

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- d) Costs; Include; Shall; May. Except as expressly provided otherwise in this Sublease, the party obligated or permitted to perform an obligation is also obligated, as between Sublessor and Sublessee, to pay the cost of performance. "Include," "includes," and "including" mean considered as part of a larger group, and not limited to the items recited. "Shall" means is obligated to. "May" means "is permitted to."
- e) Waiver. No provisions of this Sublease is waived by Sublessor or Sublessee unless waived by such party in writing. Sublessor's acceptance of rent is not a waiver of any default of Sublessee, regardless of Sublessor's knowledge of a default when it accepts the rent. No waiver by Sublessor or Sublessee of any default is a waiver of any other default of the same or any other provision of this Sublease.
- f) Remedies. The rights and remedies mentioned in this Sublease are in addition to, and do not deprive a party of, any other rights at law or in equity.
- g) Governing Law; Venue. This Sublease shall be governed by and construed in accordance with the laws of the State of Illinois. Each of Sublessor and Sublessee hereby waives any objection to the venue of any action filed by Sublessor against Sublessee (or vice versa) in any state or federal court in the jurisdiction in which the Building is located, and each of Sublessor and Sublessee further waives any right, claim or power, under the doctrine of forum non conveniens or otherwise, to transfer any such action to any other court.
- h) Authority. Sublessee and Sublessor each represents and warrants to the other that it is a duly organized corporation, limited liability company or partnership, is in good standing under the laws of the jurisdiction of its formation, is qualified to do business and is in good standing in the jurisdiction in which the Building is located, has the power and authority to enter into this Sublease, and that all corporate, limited liability company or partnership action, as applicable, requisite to authorize the representing party to enter into this Sublease has been duly taken.
- i) Attorney's Fees. The non-prevailing party in any action taken under or pursuant to this Sublease shall reimburse the prevailing party in such action for the reasonable attorneys' fees and expenses incurred by the prevailing party in connection with such action.
- j) Counterparts. To facilitate execution, this Sublease may be executed in as many counterparts as may reasonably be required; and it shall not be necessary that the signature of each party, or that the signatures of all persons required to bind any party, appear on each counterpart; but it shall be sufficient that the signature of each party, or that the signatures of the persons required to bind any party, appear on one or more of such counterparts. All counterparts shall collectively constitute a single agreement.

[Signature page attached.]

IN WITNESS WHEREOF, the parties have executed this Sublease as of the date first above written.

SUBLESSOR:
MARKETING WERKS, INC.,
an Illinois corporation

By: /s/ Julie Guida
Its: President - Marketing Werks

SUBLESSEE:
J.C. WHITNEY & CO.,

By: /s/ Tom West
Its: CEO - J.C. Whitney & Co.

EXHIBIT A

AMENDED MASTER LEASE
[Attached hereto as a separate document]

111 EAST WACKER, LLC
% PARKWAY REALTY SERVICES LLC
111 EAST WACKER DRIVE
CHICAGO, IL 60601

December __, 2007

Marketing Werks, Inc.
111 East Wacker Drive, Suite 3000
Chicago, Illinois 60601
Attention: Michael Friman

J.C. Whitney & Co.
225 North Michigan Avenue, Suite 1000
Chicago, Illinois 60601
Attention: Jerome Mascitti

RE: CONSENT TO SUBLEASE
"Building": 111 East Wacker Drive, Chicago, IL
"Premises": 30th Floor of the Building
"Sublet Space": The entire Premises
"Landlord": Parkway 233 North Michigan, LLC
"Tenant": Marketing Werks, Inc.
"Subtenant": J.C. Whitney & Co.
"Lease": Agreement dated February 24, 2005 as amended by First Amendment to Lease dated May 17, 2006 as same has been may be amended, modified, extended or restated from time to time after the date hereof.
"Sublease": Agreement annexed hereto, as same may be amended, modified, extended or restated from time to time, as may be permitted hereunder

Gentlemen:

You have requested our consent to the Sublease. Such consent is hereby granted on the terms and conditions, and in reliance upon the representations and warranties, set forth in this letter (this "Agreement").

1. Tenant represents and warrants that (a) the Lease is in full force and effect: (b) the Lease has not been assigned, encumbered, modified, extended or supplemented: (c) Tenant knows of no defense or counterclaim to the enforcement of the Lease: (d) Tenant is not entitled to any reduction, offset or abatement of the rent payable under the Lease: (e) a true and complete copy of the Sublease is attached hereto, and the Sublease constitutes the complete agreement between Tenant and Subtenant with respect to the subject matter thereof, (f) Landlord has completed all work to be performed by Landlord under the Lease and has paid all contributions and other sums due to Tenant under the Lease, and (g) neither Landlord, to Tenant's knowledge, nor Tenant is in default of any of their respective obligations or covenants, and neither has breached any of their respective representations or warranties, under the Lease.

2. The Sublease shall be subject and subordinate to the Lease and all of its precisions. Neither Tenant nor Subtenant shall take, permit or suffer any action which would violate the provisions of the Lease or this Agreement.

3. Landlord's obligations to Tenant are governed only by the Lease and this Agreement and Landlord's obligations to Subtenant are only as set forth in Paragraphs 6, 11 and 22 of this Agreement. Landlord shall not be bound or estopped by any provision of the Sublease, including any provision purporting

to impose any obligations upon Landlord (except as provided in Paragraph 6 of this Agreement). Nothing contained herein shall be construed as a consent to, approval of, or ratification by Landlord of any of the particular provisions of the Sublease or any plan or drawing referred to or contained therein except as may be expressly provided herein). Landlord has not reviewed or approved any provision of the Sublease.

4. If Tenant or Subtenant violates any of the terms of this Agreement, or if any representation by Tenant or Subtenant in this Agreement is untrue in any material respect, or if Subtenant takes any action which would constitute a default under the Lease, then Landlord may declare the Lease to be in default and avail itself of all remedies provided at law or equity or in the Lease with respect to defaults: provided that Landlord shall not exercise its right to terminate the Lease or Tenant's right to possession of the Premises unless Tenant or Subtenant does not cure such default within the cure period, if any, set forth in Section 19(a) of the Lease.

5. Subject to the provisions of Paragraph 6 of this Agreement, if the Lease is terminated prior to the stated expiration date provided in the Lease, the Sublease, on the date of such termination, shall likewise terminate. In connection with such termination, Subtenant, at its sole expense, shall surrender the Sublet Space to Landlord in the manner provided for in the Lease, including the removal of all its personal property from the Sublet Space and from any part of the Building to which it is not otherwise entitled to occupancy, and repair all resulting damage to the Sublet Space and the Building, provided, however, Subtenant shall not be obligated to remove any alterations, additions or improvements located in the Sublet Space as of the date Tenant delivers possession of the Sublet Space to Subtenant. Except as otherwise provided in the Lease, Landlord shall have the right to retain any property and personal effects which remain in the Sublet Space or the Building on the date of termination of the Sublease, without any obligation or liability to Tenant or Subtenant, and to retain any net proceeds realized from the sale thereof, without waiving Landlord's rights with respect to any default by Tenant under the Lease or Subtenant under the foregoing provisions of this paragraph and the provisions of the Lease and Sublease. If Subtenant shall fail to vacate and surrender the Sublet Space in accordance with the provisions of this paragraph, Landlord shall be entitled to all of the rights and remedies which are available to a landlord against a tenant holding over after the expiration of a term, and any such holding over shall be deemed a default under the Lease. In addition, Subtenant agrees that it will not seek, and it expressly waives any right to seek, any stay of (a) the prosecution of, or (b) the execution of any judgment awarded in, any action by Landlord to recover possession of the Sublet Space. This paragraph shall survive the earlier termination of the Lease and Sublease.

6. If the Lease is terminated or if Tenant's possession of the Premises is terminated before the stated expiration date of the Sublease, and if Landlord or any other party then entitled to possession of the Sublet Space so demands in writing to Subtenant within five (5) business days after the receipt of a final court order of possession of the Premises, Subtenant shall attorn to Landlord or any such party upon the then executor) terms of the Sublease for the remainder of the stated term of the Sublease. The party to whom Subtenant attorns shall, under such circumstances, agree not to disturb Subtenant in its use and enjoyment of the Sublet Space, provided Subtenant performs all of its obligations under the Sublease. Such party shall not be required to honor or credit Subtenant for (i) any payments of rent made to Tenant for more than one month in advance or for any other payment owing by, or on deposit with, Tenant for the credit of Subtenant except to the extent actually received by Landlord, (ii) any obligation to perform any work or make any payment to Subtenant pursuant to a work letter, the Sublease or otherwise, (iii) any security deposits not in Landlord's actual possession, (iv) any obligation of, or liability resulting from any act or omission of, Tenant, (v) any amendment of the Sublease not expressly consented to by Landlord, or (vi) any defenses, abatements, reductions, counterclaims or offsets assertable against Tenant except to the extent any such rights relate to payments made by Subtenant to Landlord on behalf of Tenant. This provision is self-operative upon demand for attornment, whether or not, as a matter of law, the Sublease may terminate upon the expiration or termination of the term of the Lease or the termination of Tenant's possession of the Premises. Subtenant however, agrees to give Landlord or such other party, on request, a commercially reasonable instrument acknowledging an attornment according to these terms. No attornment pursuant to this paragraph shall be deemed a waiver or impairment of Landlord's rights under the Lease to pursue any remedy not inconsistent with the attornment.

In the event of such election by Landlord or such other party, (i) Tenant shall deliver to Landlord or such other party any security deposit which Tenant is then holding under the Sublease and (ii) Subtenant shall reimburse Landlord or such other party for any costs that may be incurred by it in connection with such attornment, including reasonable legal fees and disbursements.

Landlord shall provide Subtenant a copy of any default notice delivered pursuant to Section 19 of the Lease at the same time such notice is delivered to Tenant. Landlord shall accept cure by Subtenant of such default within the cure period, if any, provided pursuant to Section 19 of the Lease as a cure by Tenant.

7. Tenant and Subtenant each agrees:

(i) None of Landlord's shareholders, partners, members, directors, officers, agents or employees, directly or indirectly, shall be liable for Landlord's performance under the Lease or this Agreement:

(ii) Landlord's liability shall be limited to the value of Landlord's interest in the Real Property (as defined in the Lease):

(iii) it will not seek to satisfy any judgment against Landlord out of the assets of any person or entity other than Landlord (but only to the extent provided in clause (ii) above): and

(iv) the obligations of Landlord under this Agreement shall not be binding upon Landlord after the sale, conveyance, assignment or transfer by Landlord of its interest in the Real Property, and Tenant and Subtenant shall look solely to the transferee for the satisfaction of such obligations. Any such transferee shall be deemed to have assumed all of Landlord's obligations under this Agreement.

8. Tenant and Subtenant each represents and warrants that no rent or other consideration is being paid or is payable to Tenant by Subtenant for the right to use or occupy the Sublease Space or for the use, sale or rental of Tenant's fixtures, leasehold improvements, equipment, furniture or other personal property in excess of the Base Rent and Additional Rent payable pursuant to the Lease (collectively, the "Rent") for the Sublease Space, and if such rent or other consideration exceeds such Rent, Tenant shall comply with Section 15(c) of the Lease and pay to Landlord fifty percent (50%) of such excess.

9. The expiration date of the Sublease shall be January 30, 2017, unless sooner terminated pursuant to the terms of the Lease or the Sublease.

10. If a Default (as defined in Section 19(a) of the Lease) occurs under the Lease, during the continuation of such Default, Subtenant shall, upon written notice from Landlord, pay all rent due under the Sublease directly to Landlord: provided, however, the foregoing shall not be deemed to establish any privity of estate or contract (but for the provisions of this Agreement) between Landlord and Subtenant and the Sublease shall otherwise continue to be a "sublease" between Tenant and Subtenant subject and subordinate to all of the covenants, agreements, terms, provisions and conditions of the Lease and this Agreement.

11. As additional security for Tenant's obligations under the Lease, on or before April 1, 2008, Subtenant shall deliver to Landlord a letter of credit (the "Subtenant Letter of Credit") that satisfies the terms and conditions of Section 29(b) of the Lease and the provisions of this paragraph. Anything to the contrary herein or in the Lease notwithstanding, the Subtenant Letter of Credit shall (i) be in the form attached hereto as Exhibit A, (ii) shall expire no earlier November 14, 2009, and (iii) shall be in the amount of One Hundred Thousand and 00/100 Dollars (\$100,000.00) and shall not reduce during the term of the Subtenant Letter of Credit. Landlord shall be entitled to draw on Subtenant's letter of credit in the same manner as Landlord is entitled to draw on Tenant's letter of credit pursuant to

Section 29 of the Lease, provided that Landlord shall not draw on the Subtenant Letter of Credit (a) until it has fully applied Tenant's security deposit under Section 29 of the Lease, (b) in the case of a monetary default described in Section 19(a)(i) or (ii), if Subtenant pays to Landlord the rent due under the Sublease after receipt of the notice described in Paragraph 10 above, or (c) for a default not described in Section 19(a)(i) or (ii) of the Lease caused by Tenant. Provided (i) no Default exists under the Lease, (ii) nothing has occurred that, but for the giving of notice and the expiration of a cure period, would constitute a default under the Lease, and (iii) neither Tenant nor Subtenant have violated any of the terms of this Agreement. Landlord shall return the Subtenant Letter of Credit to Subtenant on November 17, 2009. If (i) the Lease or Tenant's possession of the Premises is terminated, (ii) Landlord does not request that Subtenant attorn to Landlord pursuant to Paragraph 6. (iii) Subtenant has paid to Landlord all rent due under the Sublease after Landlord delivers the notice described in Paragraph 10 above and (iv) no Default under the Lease not caused by Tenant exists as of the date of such termination, then Landlord shall return the Subtenant Letter of Credit to Subtenant within 15 days after the termination of the Lease or Tenant's possession of the Premises. Landlord hereby approves LaSalle Bank National Association as issuer of the Subtenant Letter of Credit.

12. The Lease and this Agreement constitute the entire agreement of the parties with respect to Landlord's consent to the Sublease. This Agreement, may not be changed except in writing signed by the party to be charged.

13. All statements, notices and other communications given pursuant to this Agreement must be in writing and must be delivered personally with receipt acknowledged, or sent by a nationally recognized reputable overnight courier (against a receipt of delivery), or by registered mail, return receipt requested, addressed to the parties at their addresses set forth above, or, if to Subtenant, at the Building, or at such other address as any party may designate upon not less than 10 days prior notice given in accordance with this paragraph. Any such communication shall be deemed delivered when personally delivered, or on the date received or rejected as indicated by the receipt if sent by overnight courier or by the return receipt if sent by mail. Prior to Subtenant's occupancy of the Premises, notice to Subtenant shall be delivered to the following address: J.C. Whitney & Co. 225 North Michigan Avenue, Suite 1000, Chicago, Illinois 60601, Attention: Jerome Mascitti.

14. This Agreement will be construed and governed by Illinois law.

15. Landlord's rights and remedies under this Agreement shall be in addition to every other right or remedy available to it under the Lease, at law, in equity or otherwise and Landlord shall be able to assert its rights and remedies at the same time as before, or after its assertion of any other right or remedy to which it is entitled without in any way diminishing such other rights or remedies. The invalidity or unenforceability of any provision of this Agreement shall not impair the validity and enforceability of any other provision of this Agreement.

16. This Agreement shall bind and inure to the benefit of the parties and their respective successors and assigns, except as provided in Paragraph 7(iv) above and except that it shall not inure to the benefit of any successor or assign of Tenant or Subtenant whose status was acquired in violation of the Lease or this Agreement.

17. Each of the parties executing this Agreement represents that it is duly authorized to execute and deliver this Agreement and that each such party has full power and authority to enter into this Agreement.

18. Tenant and Subtenant, jointly and severally, indemnify Landlord against, and hold it harmless from, all costs, damages and expenses, including reasonable attorneys' fees and disbursements, arising out of any claims for brokerage commissions, finder's fees or other compensation in connection with the Sublease or procuring possession of the Sublet Space Tenant and Subtenant, at their sole expense, may defend any such claim with counsel reasonably acceptable to Landlord and settle any such claim at their expense, but only Landlord may approve the text of any stipulation, settlement agreement consent order, judgment or decree entered into on its behalf. The provisions of this Paragraph 18 shall survive the expiration or sooner termination of the Lease or Sublease.

19. Tenant and Subtenant, jointly and severally, indemnify Landlord against, and hold it harmless from any and all losses, costs, expenses, claims and liabilities including, but not limited to, reasonable counsel fees, arising from the use, occupancy, conduct or management of the Sublet Space by Subtenant, or its agents, employees, contractors, representatives or invitees, or Subtenant's business activities therein. If any proceeding is brought against Landlord by reason of any such claim, Tenant and Subtenant, jointly and severally, shall be responsible for Landlord's costs and expenses including, without limitation, reasonable attorney's fees and expenses) incurred in connection therewith. If any action or proceeding is brought against Landlord by reason of any such claim, Subtenant and for Tenant, upon written notice from Landlord, shall, at Tenant's or Subtenant's sole cost and expense, as the case may be, resist or defend such action or proceeding using counsel reasonably approved by Landlord, but may not settle any such claim without Landlord's prior written approval. The provisions of this Paragraph 19 shall survive the expiration or earlier termination of the term of the Sublease or the Lease. The indemnity and any right granted to Landlord pursuant to this paragraph shall be in addition to, and not in limitation of Landlord's rights under the Lease.

20. Subtenant shall carry insurance during the entire term required to be carried by Tenant under the Lease. Landlord and Subtenant agree to have all physical damage or material damage insurance which may be carried by either of them, and Subtenant agrees to have all business interruption insurance which it carries, endorsed to provide that any release from liability of, or waiver of claim for, recovery from the other party entered into in writing by the insured thereunder prior to any loss or damage shall not affect the validity of said policy or the right of the insured to recover thereunder and providing further that the insurer waives all rights of subrogation which such insurer might have against the other party. Without limiting any release or waiver of liability or recovery contained in any other section of the Lease, but rather in confirmation and furtherance thereof each of the parties hereto waives all claims for recovery from the other party for any loss or damage to any of its property or damages as a result of business interruption. Notwithstanding the foregoing or anything contained in the Lease to the contrary, any release and any waiver of claims shall not be operative, nor shall the foregoing endorsements be required, in any case where the effect of such release and waiver is to invalidate insurance coverage or increase the cost thereof (provided that, in the case of increased cost, the other party shall have the right, within ten (10) days following written notice, to pay such increased cost keeping such release and waiver in full force and effect).

21. Landlord's consent to the Sublease does not include consent to any modification, supplement or amendment of the Sublease, or to any assignment of the Sublease or sub-subletting of the Sublet Space or any additional subleasing of the Sublet Space or any other portion of the Premises whether pursuant to an option or right contained in the Sublease or otherwise, each of which requires Landlord's prior written consent (except that Tenant and Subtenant may terminate the Sublease without Landlord's prior consent). If Tenant, or Subtenant desires Landlord's consent to any such other action it must specifically and separately request such consent and in the case of an assignment or sublease the provisions of Article 15 of the Lease shall apply to such request (and if such request is made by Subtenant, said Article 15 shall apply in the same manner as if such request was made by Tenant). Tenant shall give Landlord prompt written notice if the Sublease terminates prior to its stated term. Notwithstanding the foregoing, the provisions of Section 15(h) of the Lease permitting an assignment of the Lease or a sublease of the Premises without Landlord's consent shall also apply to Subtenant in the same manner as if Subtenant were Tenant.

22. Landlord agrees as follows:

- (i) The performance by Subtenant under the Sublease shall constitute performance by Tenant under the Lease (except for the payment of rent).
- (ii) This consent satisfies the requirements of Article 13 of the Lease.

(iii) Landlord certifies that it has not received written notice that any existing condition of the Premises is in violation of any statute or ordinance.

(iv) Landlord certifies to Subtenant that: (a) the Lease has not been canceled, modified, extended or amended except as noted above; (b) to the best of Landlord's knowledge, the Lease has not been assigned by Tenant; (c) to the best of Landlord's knowledge, Tenant is not in default under the terms of the Lease and no notice of an Event of Default has been delivered to Tenant and (d) the Prime Lease is in full force and effect.

(v) Subtenant shall have the right to request after-hours heating, ventilation and air conditioning ("HVAC") services for the Premises directly from Landlord. In the event Subtenant requests such after-hours HVAC services, Landlord shall provide such after-hours HVAC services in accordance with the terms of the Lease and Landlord shall bill Subtenant directly for such after-hours HVAC. Subtenant shall pay such bill to Landlord as Additional Rent in accordance with the terms and provisions of the Lease. Tenant agrees to the provisions of this Section 22(v) and acknowledges that, notwithstanding the fact that Landlord will bill Subtenant directly for the after-hours HVAC costs, such costs shall be considered additional Rent under the Lease.

23. Neither the execution and delivery of this Agreement or the Sublease, nor any acceptance of rent or other consideration from Subtenant by Landlord or Landlord's agent shall operate to waive, modify, impair, release or in any manner affect Tenant's liability or obligations under the Lease or Subtenant's liability or obligations under the Sublease.

24. If there shall be any conflict or inconsistency between the terms, covenants and conditions of this Agreement or the Lease and the Sublease, then the terms, covenants and conditions of this Agreement or the Lease shall prevail. If there shall be any conflict or inconsistency between this Agreement and the Lease then the terms, covenants and conditions of this Agreement shall prevail.

25. Each of the parties hereby irrevocably and unconditionally waives its right to a jury trial in any cause of action arising out of, or relating to, this Agreement.

26. Tenant agrees to pay, upon demand, Landlord's reasonable out-of-pocket fees and disbursements incurred in connection with and related to the preparation and execution of this Agreement.

27. This Agreement may be executed in counterparts, each of which shall be deemed an original, and all such counterparts shall together constitute one and the same instrument.

Please acknowledge your agreement to the terms and conditions of this Agreement by signing the copy of this Agreement enclosed herewith and returning it to the Landlord. You may consider Landlord's consent to be effective upon your receipt of a fully executed copy of this Agreement.

Very truly yours,

111 East Wacker, LLC

By: Parkway Chicago, LLC
Its: Sole Member

By: /s/ Jay Buckley
Its: Senior Vice President

Agreed to:

TENANT

Marketing Werks, Inc.

By: /s/ Julie Guida
Its: President

SUBTENANT

J.C. Whitney & Co.

By: /s/ Tom West
Its: CEO

EXHIBIT A

IRREVOCABLE LETTER OF CREDIT

December __, 2007

Beneficiary:

111 EAST WACKER LLC
C/O PARKWAY REALTY SERVICES LLC
111 EAST WACKER DRIVE
CHICAGO, IL 60601
Attention: PROPERTY MANAGER

Our irrevocable standby Letter of Credit:

No. _____

Applicant:

J.C. Whitney & Co.
225 North Michigan Avenue, Suite 1000
Chicago, Illinois 60601
Attention: Jerome Mascitti

Amount: Exactly One Hundred Thousand and 00/100 U.S. Dollars (\$100,000.00)

Initial Expiration Date: _____

Final Date of Expiration: November 14, 2009

We (the "Bank") hereby issue our irrevocable standby Letter of Credit No. _____ in Beneficiary's favor for the account of the above-referenced Applicant, in the aggregate amount of exactly USD \$100,000.00.

This Letter of Credit is available with us at our above office by presentation of your draft drawn on us at sight bearing the clause: "Drawn under _____ LaSalle Bank, N.A. Letter of Credit No. _____" and accompanied by the original of this Letter of Credit and the following document:

Beneficiary's statement purportedly signed by an officer or authorized agent of Beneficiary or Beneficiary's authorized managing agent, reading

"The amount of this drawing under Irrevocable Letter of Credit No. is being drawn pursuant to that certain (i) Lease dated February 24, 2005 between Lincoln-Carlyle Illinois Center. L.L.C., as landlord, and Marketing Works. Inc., as tenant, as such lease has been amended or assigned, and (ii) that certain Consent to Sublease dated as of _____, 200__, between Parkway 233 North Michigan, LLC, as landlord, Marketing Werks, Inc., as tenant, and J.C. Whitney & Co., as subtenant, as such Consent to Sublease has been amended or assigned.

Such sight draft may be signed by Beneficiary or Beneficiary's managing agent.

Special conditions:

Partial draws, as well as multiple presentations and drawings, under this Letter of Credit are permitted. This Letter of Credit shall be automatically extended for an additional period of one (1) year, without amendment, from the Initial Expiration Date or each future expiration date unless, at least forty-five (45) days prior to the then current expiration date, we notify you by registered mail/overnight courier service at the above address that this Letter of Credit will not be extended beyond the current expiration date. Notwithstanding anything to the contrary contained herein, this Letter of Credit shall expire permanently without renewal on November 14, 2009.

We hereby agree with you that all drafts drawn under and in compliance with the terms of this Letter of Credit will be duly honored upon presentation to us on or before the expiration date of this Letter of Credit, regardless of whether Applicant disputes such presentation.

This Letter of Credit is transferable one or more times and any such transfer shall be effected by us, provided that you deliver to us your written request for transfer in form and substance reasonably satisfactory to us. Beneficiary may, at any time and without notice to Applicant and without first obtaining Applicant's consent thereto, transfer all or any portion of Beneficiary's interest in and to the Letter of Credit to a transferee of Beneficiary's interest in, or to any person holding a mortgage encumbering Beneficiary's interest in 111 East Wacker Drive, Chicago, Illinois. The original of this Letter of Credit together with any amendments thereto must accompany any such transfer request.

Except so far as otherwise expressly stated, this documentary credit is subject to International Standby Practices 1998, International Chamber Of Commerce Publication No 590.

By: _____
Authorized signature

Please direct any correspondence including drawing or inquiry quoting our reference number to the above referenced address.

SECOND AMENDMENT TO LEASE AGREEMENT

THIS SECOND AMENDMENT TO LEASE AGREEMENT (this "Second Lease Amendment") is dated as of February 1, 2008, by and between JCM MANAGEMENT LLC, an Ohio limited liability company ("Landlord"), and STYLIN' CONCEPTS CORP., an Ohio corporation ("Tenant").

BACKGROUND

A. WHEREAS, Landlord and Tenant are parties to that certain Lease Agreement dated January 1, 2003, and amended as of October 3, 2003 (as amended, the "Lease"), whereby Tenant leased from Landlord certain real property located at 7820 E. Pleasant Valley Road, Independence, Ohio, as more particularly described in the Lease (the "Premises").

B. WHEREAS, Landlord and Tenant subsequently agreed to extend the expiration of the term of the Lease until January 31, 2008, on the same terms and conditions as set forth in the Lease.

C. WHEREAS, Tenant and Landlord desire to further amend the Lease to provide for the matters contained herein.

NOW, THEREFORE, for good and valuable consideration received by each of them, the parties agree as follows:

TERMS

1. Defined Terms. Unless otherwise defined herein or unless the context clearly requires a different meaning, the capitalized words and phrases used herein shall have the same meanings ascribed to them in the Lease.

2. Term. Section 2(a) of the Lease is hereby deleted in its entirety and the following is substituted in lieu thereof:

"(a) Unless sooner terminated under the provisions of this Lease, the initial term of this Lease shall expire on January 31, 2013 (the 'Initial Term'); *provided, however*, that, so long as Tenant is not then in default under any of the terms of the Lease beyond any applicable notice and grace periods, Tenant may, by giving written notice no less than 180 days prior to the expiration date of the then-current term, extend the term of this Lease for two additional periods of five years each (each additional period, an 'Additional Term') on the same terms as set forth herein, except that the Rent (hereinafter defined) to be paid during such Additional Term shall be as set forth in Section 3(b) of the Lease. The Initial Term and any Additional Term(s) are hereinafter referred to collectively as the 'Term.'"

3. Rent. Section 3(a) of the Lease is hereby deleted in its entirety and the following is substituted in lieu thereof:

“(a) Commencing on February 1, 2008, Tenant shall pay Landlord annual rent (“Rent”) of \$200,000 per year, payable in equal monthly installments of \$16,666.67 on the first day of each month during the Initial Term. If this Lease shall commence on a day other than the first day of a month, or shall expire on a day other than the last day of a month, the installment of Rent for such month shall be prorated based on a ratio the numerator of which shall be the number of days during such month that this Lease was in effect and the denominator of which shall be the total number of days in such month. The foregoing notwithstanding, Rent for the months of February, March and April, 2008 shall be abated and Rent payments shall recommence on May 1, 2008.”

4. Assignments and Subletting. Section 10 of the Lease (as revised by Section 5 of the amendment to Lease) is hereby deleted in its entirety and the following is substituted in lieu thereof:

“10. Assignment and Subletting

(a) In connection with a conveyance of the Premises by Landlord, Landlord shall have the right to assign this Lease to the buyer of the Premises without the consent of Tenant. For purposes of this Second Lease Amendment, the term “conveyance” shall include, without limitation, in addition to any sale to an unrelated party, any change in the equity ownership of Landlord for estate planning purposes or in connection with an internal restructuring of Tenant, or the conveyance to any entity directly or indirectly controlling, controlled by, or under common control with Landlord or the acquirer of all or substantially all of the assets or equity interests of Landlord.

(b) Tenant shall not Transfer (defined herein) or permit to be Transferred this Lease or an interest therein or the estate created thereby without Landlord’s prior written approval, such approval not to be unreasonably withheld, conditioned, or delayed.

(c) ‘Transfer’ includes the occurrence of any of the following events, whether such events occur by action of Tenant, inaction of Tenant, or by operation of law: (i) any conveyance of any right of occupancy granted under this Lease, whether by sale, assignment, sublease, license, concession, franchise, or otherwise to any entity other than Tenant (including to any entity owned or controlled by Tenant, any entity which owns or controls Tenant, or any other entity related to or affiliated with Tenant); (ii) any encumbrance of the estate or interest created by this Lease, whether by mortgage, lien, pledge, or otherwise; and/or (iii) any arrangement (including without limitation management agreements and office sharing agreements) that allows the use or occupancy of all or part of the Premises by anyone or any entity other than Tenant; provided, however, that the following events shall not be considered a ‘Transfer’ for purposes of this Lease: (x) any change in ownership or power to vote, on a cumulative basis, of a majority’s of Tenant’s outstanding stock, partnership interests, or other ownership interests, (y) the merger or consolidation of the Tenant with or into one or more other entities, and (z) an assignment or other transfer of this Lease to any entity directly or indirectly controlling, controlled by, or under common control with Tenant or the acquirer of all or substantially all of the assets or equity interests of Tenant.

(d) In the event of a permitted Transfer pursuant to clauses (c)(i) or (iii) above which involves the use of any currently occupied portion of the Premises, Landlord and Tenant shall share equally all monthly rents payable by the transferee which are in excess of the monthly Rent payable by Tenant under this Lease, after deducting the reasonable out-of-pocket costs Tenant incurs to third parties in connection with such Transfer.”

5. Storage. Tenant agrees that Landlord shall have the right to store materials, without charge, in 1,000 square feet of the warehouse portion of the Premises. Landlord and Tenant shall agree on and designate a mutually agreeable location for such storage. Such right to store materials is subject to the following terms and conditions:

- a. Landlord shall not interfere with Tenant’s use or occupancy of the Premises.
- b. Landlord shall not store any Hazardous Substances in the Premises.
- c. To the extent not prohibited by law or caused by the gross negligence or willful misconduct of Tenant: (i) Landlord hereby expressly waives all claims and rights of recovery against Tenant and its officers, agents, directors, representatives, shareholders, members, subsidiaries, affiliates, related entities, partners, employees and lenders (collectively, “Tenant’s Indemnitees”) for any loss or damage to any property of Landlord stored at the Premises, regardless of the amount of insurance proceeds collected or collectible under any insurance policies in effect, and (ii) Landlord further agrees that all such property of Landlord stored at the Premises shall be at the risk of Landlord only and Tenant and Tenant’s Indemnitees shall not be liable for any loss or damage thereto or theft or conversion thereof and Landlord completely releases and exculpates Tenant and Tenant’s Indemnitees therefrom.
- d. To the extent not prohibited by law or caused by the gross negligence or willful misconduct of Tenant, Landlord agrees to indemnify, defend and hold harmless Tenant, and Tenant’s Indemnitees from and against any and all claims, demands, actions, liabilities, losses, injuries, fines, penalties, liens, damages, costs and expenses (including attorneys’ fees) incurred by Tenant or the Tenant Indemnitees, for injuries to any persons and damage to or theft or misappropriation or loss of property occurring in or about the Premises arising from Landlord’s storage of materials in the Premises.
- e. Landlord shall provide Tenant with not less than 24 hours advance verbal or written notice in each instance prior to Landlord’s entry upon the Premises for purposes of storing or removing Landlord’s materials from or on the Premises. Tenant shall have the right to accompany Landlord, its agents or representatives upon any such entry upon the Premises. At Tenant’s request, Landlord shall secure Landlord’s stored materials at the Premises in accordance with Tenant’s reasonable instructions.

6. Ratification of Lease. This Second Lease Amendment shall be deemed to form a part of and shall be construed in connection with and as part of the Lease. Except as hereinbefore expressly amended, all of the other terms, covenants, and conditions contained in the Lease shall continue to remain unchanged and in full force and effect and are hereby ratified and confirmed. If a conflict shall arise between the terms and provisions of this Second Lease Amendment and the terms and provisions of the Lease, the terms and provisions of this Second Lease Amendment shall govern.

7. Binding Effect. Each of the provisions of this Second Lease Amendment shall extend to and shall, as the case may require, bind or inure to the benefit not only of Landlord and of Tenant, but also of their respective permitted successors and assigns.

8. Counterparts. This Second Lease Amendment may be executed in multiple copies and multiple counterparts, each of which shall be deemed to form one instrument. Executed facsimile copies of this Agreement or any amendments hereto shall be binding upon the parties, and facsimile signatures appearing hereon or thereon shall be deemed to be original signatures.

9. Time of Essence. Time is of the essence for this Second Lease Amendment.

10. Representation. The undersigned, John A. Milos, hereby represents and warrants that he has full power and authority to execute and deliver this Second Lease Amendment on behalf of Landlord, and, that upon his signature hereto, this Second Lease Amendment shall constitute the legal, valid, and binding obligation of Landlord. The undersigned, Tom West, hereby represents and warrants that he has full power and authority to execute and deliver this Second Lease Amendment on behalf of Tenant, and, that upon his signature hereto, this Second Lease Amendment shall constitute the legal, valid, and binding obligation of Tenant.

11. Governing Law. This Second Lease Amendment shall be governed by and construed under Ohio law, without regard to conflict of laws principles.

[remainder of page intentionally blank]

IN WITNESS WHEREOF, Landlord and Tenant have executed this Second Lease Amendment as of the day and year first above shown.

LANDLORD:

JCM MANAGEMENT LLC, an Ohio limited liability company

By: /s/ John A. Milos

Print Name: John A. Milos

Title: President

TENANT:

STYLIN' CONCEPTS CORP., an Ohio corporation

By: /s/ Tom West

Print Name: Tom West

Title: CEO

036797, 000003, 101958505.3, Second Amendment to Lease 1-22-08

SUBSIDIARIES OF THE REGISTRANT

Name	Jurisdiction	DBA
PartsBin, Inc.	Delaware	
Power Host, Inc.(1)	Ontario, Canada	
U.S. Auto Parts Network (Philippines) Corporation	Philippines	
Lobo Marketing, Inc.	Texas	
Go Fido, Inc.	Delaware	
Private Label Parts, Inc.	Delaware	Kool-Vue
Pacific 3PL, Inc.	Delaware	
AutoMD, Inc.	Delaware	
Local Body Shops, Inc.	Delaware	Perfect Fit
Automotive Specialty Accessories and Parts, Inc. (2)	Delaware	
Whitney Automotive Group, Inc. (3)	Delaware	
Value Solutions, Inc. (3)	Delaware	

(1) Subsidiary of PartsBin, Inc.

(2) Subsidiary of Go Fido, Inc.

(3) Subsidiary of Automotive Specialty Accessories and Parts, Inc.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-143179, 333-149973, and 333-158224 on Form S-8 and Registration Statement No. 333-163811 on Form S-3/A of our reports dated March 16, 2011, relating to the financial statements of U.S. Auto Parts Network, Inc. and subsidiaries, and the effectiveness of U.S. Auto Parts Network, Inc. and subsidiaries internal control over financial reporting, appearing in this Annual Report on Form 10-K of U.S. Auto Parts Network, Inc. and subsidiaries for the period ended January 1, 2011.

/s/ Deloitte & Touche LLP

Los Angeles, CA

March 16, 2011

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the following Registration Statements:

- (1) Registration Statement (Form S-8 333-143179) pertaining to the 2007 Omnibus Incentive Plan and the 2006 Equity Incentive Plan of U.S. Auto Parts Network, Inc.,
- (2) Registration Statement (Form S-8 333-149973) pertaining to 2007 New Employee Incentive Plan and the 2007 Omnibus Incentive Plan of U.S. Auto Parts Network, Inc.,
- (3) Registration Statement (Form S-8 333-158224) pertaining to the 2007 Omnibus Incentive Plan of U.S. Auto Parts Network, Inc., and
- (4) Registration Statement (Form S-3/A 333-163811) pertaining to the Prospectus of U.S. Auto Parts Network, Inc. for the registration of 2,500,000 shares of its common stock.

of our report dated March 12, 2010, with respect to the consolidated financial statements of U.S. Auto Parts Network, Inc. included in this Annual Report (Form 10-K) for the year ended January 1, 2011.

/s/Ernst & Young LLP

Los Angeles, California
March 16, 2011

**CERTIFICATION PURSUANT TO EXCHANGE ACT
RULE 13a-14(a)/15d-14(a), AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Shane Evangelist, certify that:

1. I have reviewed this annual report on Form 10-K of U.S. Auto Parts Network, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2011

/s/ SHANE EVANGELIST

Shane Evangelist
Chief Executive Officer
(principal executive officer)

**CERTIFICATION PURSUANT TO EXCHANGE ACT
RULE 13a-14(a)/15d-14(a), AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Theodore Sanders, certify that:

1. I have reviewed this annual report on Form 10-K of U.S. Auto Parts Network, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2011

/s/ THEODORE SANDERS

Theodore Sanders
Chief Financial Officer
(principal financial officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of U.S. Auto Parts Network, Inc. (the "Company") on Form 10-K for the fiscal year ended January 1, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Shane Evangelist, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: March 16, 2011

/s/ SHANE EVANGELIST

Shane Evangelist
Chief Executive Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of U.S. Auto Parts Network, Inc. (the "Company") on Form 10-K for the fiscal year ended January 1, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Theodore Sanders, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: March 16, 2011

/s/ THEODORE SANDERS

Theodore Sanders
Chief Financial Officer