U.S. Auto Parts Network, Inc.
Form 10-Q
August 09, 2016

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 2, 2016
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 001-33264

U.S. AUTO PARTS NETWORK, INC.
(Exact name of registrant as specified in its charter)

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

16941 Keegan Avenue, Carson, CA 90746
(Address of Principal Executive Office) (Zip Code)
(310) 735-0085
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No ý
As of August 4, 2016, the registrant had 34,888,960 shares of common stock outstanding, $0.001 par value.

U.S. AUTO PARTS NETWORK, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THIRTEEN WEEKS ENDED JULY 2, 2016
TABLE OF CONTENTS

		Page
	PART I. FINANCIAL INFORMATION	
ITEM 1.	Financial Statements	4
	Consolidated Balance Sheets (Unaudited) at July 2, 2016 and January 2, 2016	4
	Consolidated Statements of Comprehensive Operations (Unaudited) for the Thirteen and Twenty-Six Weeks Ended July 2, 2016 and July 4, 2015	5
	Consolidated Statements of Cash Flows (Unaudited) for the Twenty-Six Weeks Ended July 2, 2016 and July 4, 2015	6
	Notes to Consolidated Financial Statements (Unaudited)	7
ITEM 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
ITEM 3.	Quantitative and Qualitative Disclosures About Market Risk	29
ITEM 4.	Controls and Procedures	29
	PART II. OTHER INFORMATION	
ITEM 1.	Legal Proceedings	31
ITEM 1A.	Risk Factors	31
ITEM 2.	Unregistered Sales of Equity Securities and Use of Proceeds	45
ITEM 3.	Defaults Upon Senior Securities	45
ITEM 4.	Mine Safety Disclosures	45
ITEM 5.	Other Information	45
ITEM 6.	Exhibits	46

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 wholly-owned and majority-owned subsidiaries. Unless otherwise stated, all amounts are presented in thousands. In addition, unless the context requires otherwise, references to AutoMD refer to AutoMD, Inc., our majority-owned subsidiary.

U.S. Auto Parts®, U.S. Auto Parts Network™, AutoMD®, AutoMD Insta-Quotes! ®, Kool-Vue™, 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 "will likely result" and variations of these words or similar expressions. These forward-looking statements include, but are not limited to, statements regarding future events, our future operating and financial results, financial expectations, expected growth and strategies, current business indicators, capital needs, financing plans, capital deployment, liquidity, contracts, litigation, product offerings, customers and suppliers, acquisitions, competition and the status of our facilities. Forward-looking statements, no matter where they occur in this document or in other statements attributable to the Company involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. We discuss many of these risks in greater detail under the heading "Risk Factors" in Part II, Item 1A of this report. Given these uncertainties, you should not place undue reliance on these forward-looking statements. You should read this report and the documents that we reference in this report and have filed as exhibits to the report completely and with the understanding that our actual future results may be materially different from what we expect. Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited, In Thousands, Except Par Value and Per Share Liquidation Value)

	July 2, 2016	January 2, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$4,913	$5,537
Short-term investments	77	65
Accounts receivable, net of allowances of $36 and $17 at July 2, 2016 and January 2, 2016, respectively	2,971	3,236
Inventory	44,421	51,216
Other current assets	3,489	2,475
Total current assets	55,871	62,529
Property and equipment, net	17,900	18,431
Intangible assets, net	1,235	1,476
Other non-current assets	1,212	1,320
Total assets	$76,218	$83,756
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$26,545	$25,523
Accrued expenses	7,452	7,267
Revolving loan payable	—	11,759
Current portion of capital leases payable	533	521
Other current liabilities	4,174	3,854
Total current liabilities	38,704	48,924
Capital leases payable, net of current portion	10,053	10,168
Deferred income taxes	690	944
Other non-current liabilities	1,677	1,577
Total liabilities	51,124	61,613
Commitments and contingencies		
Stockholders' equity:		
Series A convertible preferred stock, $0.001 par value; $1.45 per share liquidation value or aggregate of $6,017; 4,150 shares authorized; 4,150 shares issued and outstanding at July 2, 2016 and January 2, 2016	4	4
Common stock, $0.001 par value; 100,000 shares authorized; 34,888 and 34,137 shares issued and outstanding at July 2, 2016 and January 2, 2016	35	34
Additional paid-in capital	178,279	176,873
Accumulated other comprehensive income	432	440
Accumulated deficit	(154,944)	(157,011)
Total stockholders' equity	23,806	20,340
Noncontrolling interest	1,288	1,803
Total equity	25,094	22,143
Total liabilities and stockholders' equity	$76,218	$83,756

See accompanying notes to consolidated financial statements (unaudited).

4

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE OPERATIONS
(Unaudited, in Thousands, Except Per Share Data)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2 2016	July 4 2015	July 2 2016	July 4 2015
Net sales	$ 78,055	$ 76,462	$ 158,861	$ 152,850
Cost of sales [1]	54,301	55,594	110,515	110,504
Gross profit	23,754	20,868	48,346	42,346
Operating expenses:				
Marketing	11,046	11,148	22,536	22,000
General and administrative	4,626	4,484	9,111	8,665
Fulfillment	5,658	4,978	11,696	10,038
Technology	1,438	1,250	2,715	2,538
Amortization of intangible assets	121	115	241	230
Total operating expenses	22,889	21,975	46,299	43,471
Income (loss) from operations	865	(1,107)	2,047	(1,125)
Other income (expense):				
Other income, net	11	10	17	33
Interest expense	(251)	(272)	(598)	(645)
Total other expense, net	(240)	(262)	(581)	(612)
Income (loss) before income taxes	625	(1,369)	1,466	(1,737)
Income tax benefit	(56)	(347)	(205)	(399)
Net income (loss) including noncontrolling interests	681	(1,022)	1,671	(1,338)
Net income (loss) attributable to noncontrolling interests	(253)	(247)	(515)	(503)
Net income (loss) attributable to U.S. Auto Parts	934	(775)	2,186	(835)
Other comprehensive loss attributable to U.S. Auto Parts:				
Foreign currency translation adjustments	(8)	(12)	(13)	(22)
Total other comprehensive loss attributable to U.S. Auto Parts	(8)	(12)	(13)	(22)
Comprehensive income (loss) attributable to U.S. Auto Parts	$ 926	$ (787)	$ 2,173	$ (857)
Net income (loss) attributable to U.S. Auto Parts per share:				
Basic net income (loss) per share	$ 0.03	$ (0.02)	$ 0.06	$ (0.03)
Diluted net income (loss) per share	$ 0.02	$ (0.02)	0.05	(0.03)
Weighted average common shares outstanding:				
Shares used in computation of basic net income (loss) per share	34,753	33,963	34,625	33,842
Shares used in computation of diluted net income (loss) per share	40,007	33,963	39,655	33,842

(1) Excludes depreciation and amortization expense which is included in marketing, general and administrative and fulfillment expense.

See accompanying notes to consolidated financial statements (unaudited).

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

	Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015
Operating activities		
Net income (loss) including noncontrolling interests	$1,671	$(1,338)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization expense	3,704	3,756
Amortization of intangible assets	241	230
Deferred income taxes	(257)	(452)
Share-based compensation expense	1,668	1,106
Stock awards issued for non-employee director service	4	—
Amortization of deferred financing costs	41	41
Gain from disposition of assets	—	(13)
Changes in operating assets and liabilities:		
Accounts receivable	265	686
Inventory	6,795	3,142
Other current assets	(1,038)	(142)
Other non-current assets	81	40
Accounts payable and accrued expenses	1,308	(1,258)
Other current liabilities	319	798
Other non-current liabilities	204	(110)
Net cash provided by operating activities	15,006	6,486
Investing activities		
Additions to property and equipment	(2,887)	(3,832)
Proceeds from sale of property and equipment	—	13
Cash paid for intangible assets	(125)	(25)
Net cash used in investing activities	(3,012)	(3,844)
Financing activities		
Borrowings from revolving loan payable	9,297	7,014
Payments made on revolving loan payable	(21,056)	(10,050)
Proceeds from stock options	536	40
Payments on capital leases	(313)	(131)
Statutory tax withholding payment for share-based compensation	(969)	(438)
Payment of liabilities related to financing activities	(100)	(100)
Net cash used in financing activities	(12,605)	(3,665)
Effect of exchange rate changes on cash	(13)	(22)
Net change in cash and cash equivalents	(624)	(1,045)
Cash and cash equivalents, beginning of period	5,537	7,653
Cash and cash equivalents, end of period	$4,913	$6,608
Supplemental disclosure of non-cash investing and financing activities:		
Accrued asset purchases	$735	$791
Property acquired under capital lease	211	368
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	$49	$58
Cash paid during the period for interest	564	590

See accompanying notes to consolidated financial statements (unaudited).

6

U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In Thousands, Except Per Share Data)

Note 1 – Basis of Presentation and Description of Company

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

The Company's products consist of collision parts serving the body repair market, engine parts to serve the replacement parts market, and performance parts and accessories. The collision parts category is primarily comprised of body 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. 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 also 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 has employees located in both the United States and the Philippines.

Basis of Presentation

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions to U.S. Securities and Exchange Commission ("SEC") Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of July 2, 2016 and the consolidated results of operations and cash flows for the thirteen and twenty-six weeks ended July 2, 2016 and July 4, 2015. The Company's results for the interim periods are not necessarily indicative of the results that may be expected for any other interim period, or for the full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended January 2, 2016, which was filed with the SEC on March 11, 2016 and all our other periodic filings, including Current Reports on Form 8-K, filed with the SEC after the end of our 2015 fiscal year, and throughout the date of this report.

During the thirteen and twenty-six weeks ended July 2, 2016, the Company had a net income of $934 and $2,186, respectively, compared to a net loss of $775 and $835 during the thirteen and twenty-six weeks ended July 4, 2015, respectively. Based on our current operating plan, we believe that our existing cash, cash equivalents, investments, cash flows from operations and available debt financing will be sufficient to finance our operational cash needs through at least the next twelve months.

Segment Data

The Company operates in two reportable operating segments. The criteria the Company uses to identify operating segments are primarily the nature of the products we sell or services we provide and the consolidated operating results that are regularly reviewed by our chief operating decision maker to assess performance and make operating decisions. We identified two reportable operating segments, the core auto parts business ("Base USAP"), and an online automotive repair information source of which we are a majority stockholder ("AutoMD").

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-09, "Compensation - Stock Compensation" ("ASU 2016-09"). The objective of this update is to simplify accounting related to stock compensation. The new standard is effective for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. The Company is evaluating the effect that ASU 2016-09 will have on the consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has the effect of the standard on ongoing financial reporting been determined.

Note 2 –Intangible Assets, Net

Intangible assets consisted of the following at July 2, 2016 and January 2, 2016 (in thousands):

		July 2, 2016			January 2, 2016		
	Useful Life	Gross Carrying Amount	Accumulated Amort. and Impairment	Net Carrying Amount	Gross Carrying Amount	Accumulated Amort. and Impairment	Net Carrying Amount
Intangible assets subject to amortization:							
Product design intellectual property	4 years	$2,750	$ (2,491)	$ 259	$2,750	$ (2,361)	$ 389
Patent license agreements	3 - 5 years	562	(281)	$ 281	562	(219)	$ 343
Domain and trade names	10 years	1,407	(712)	$ 695	1,407	(663)	$ 744
Total		$4,719	$ (3,484)	$ 1,235	$4,719	$ (3,243)	$ 1,476

Intangible assets subject to amortization are amortized on a straight-line basis. Amortization expense relating to intangible assets for the thirteen weeks ended July 2, 2016 and July 4, 2015 was $121 and $115, respectively. Amortization expense relating to intangible assets for the twenty-six weeks ended July 2, 2016 and July 4, 2015 was $241 and $230, respectively.

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

2016	$241
2017	344
2018	185
2019	100
2020	100
Thereafter	265
Total	$1,235

Note 3 – Borrowings

The Company maintains an asset-based revolving credit facility ("Credit Facility") that provides for, among other things, a revolving commitment in an aggregate principal amount of up to $30,000, which is subject to a borrowing base derived from certain receivables, inventory, and property and equipment. The Credit Facility matures on April 26, 2017. At July 2, 2016, our outstanding revolving loan balance was $0.

On May 6, 2016, the Company and JPMorgan Chase Bank, N.A. ("JPMorgan") entered into a Ninth Amendment to Credit Agreement and Second Amendment to Pledge and Security Agreement (the "Amendment"), which amended the Credit
Agreement previously entered into by the Company, certain of its domestic subsidiaries and JPMorgan on April 26, 2012 (as

amended, the “Credit Agreement”) and the Pledge and Security Agreement previously entered into by the Company, certain of
its domestic subsidiaries and JPMorgan on April 26, 2012. Pursuant to the Amendment, letters of credit can be issued if after giving effect to such issuance, the letters of credit exposure shall not exceed $15,000, which was an increase from the previously agreed upon $6,000. As of July 2, 2016, our outstanding letters of credit balance was $5,283.
Loans drawn under the Credit Facility bear interest, at the Company’s option, at a per annum rate equal to either (a) LIBOR plus an applicable margin of 1.50%, or (b) a “base rate” subject to an increase or reduction by up to 0.25% per annum based on the Company's fixed charge coverage ratio. At July 2, 2016, the Company’s LIBOR based interest rate was 2.00% (on $0 principal) and the Company’s prime based rate was 3.50% (on $0 principal). A commitment fee, based upon undrawn availability under the Credit Facility bearing interest at a rate of 0.25% per annum, is payable monthly. Under the terms of the Credit Agreement, cash receipts are deposited into a lock-box, which are at the Company’s discretion unless the “cash dominion period” is in effect, during which cash receipts will be used to reduce amounts owing under the Credit Agreement. The cash dominion period is triggered in an event of default or if excess availability is less than the $3,600 for five business days (on a cumulative basis) and will continue until, during the preceding 60 consecutive days, no event of default existed and excess availability has been greater than $3,600 at all times (with such trigger subject to adjustment based on the Company's revolving commitment). In addition, in the event that “excess availability,” as defined under the Credit Agreement, is less than $2,400, the Company shall be required to maintain a minimum fixed charge coverage ratio of 1.0 to 1.0 (with the trigger subject to adjustment based on the Company's revolving commitment).
The Company's excess availability was $16,000 at July 2, 2016. As of the date hereof, the cash dominion period has not been in effect; accordingly, no principal payments are due.

Note 4 – Stockholders’ Equity and Share-Based Compensation
Non-Controlling Interest
Non-controlling interests represent equity interests in consolidated subsidiaries that are not attributable, either directly or indirectly, to the Company (i.e., minority interests). Non-controlling interests consist of the minority equity holders' proportionate share of the equity of AutoMD. Ownership interests in subsidiaries held by parties other than the Company are presented as non-controlling interests within stockholders' equity, separately from the equity held by the Company. Revenues, expenses, net income (loss) and other comprehensive loss are reported in the consolidated financial statements at the consolidated amounts, which includes amounts allocated to both the Company's interest and the non-controlling interests in AutoMD. Net loss and other comprehensive loss is then attributed to the Company's interest and the non-controlling interests. Net income (loss) to non-controlling interests is deducted from net income (loss) in the consolidated statements of comprehensive operations to determine net income (loss) attributable to the Company's common stockholders.
The following table summarizes the Company’s stock option activity under the AutoMD 2014 Equity Incentive Plan (the "AMD Plan") for the twenty-six weeks ended July 2, 2016, and details regarding the options outstanding and exercisable at July 2, 2016:

	Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding, January 2, 2016	1,430	$1.00		
Granted	10	$1.00		
Exercised	—	—		
Expired	—	—		
Forfeited	(35)	$1.00		
Options outstanding, July 2, 2016	1,405	$1.00	8.70	$ —
Vested and expected to vest at July 2, 2016	1,047	$1.00	8.69	$ —
Options exercisable, July 2, 2016	429	$1.00	8.56	$ —

At July 2, 2016, 545 shares were available for future grants under the AMD Plan.

The weighted-average fair value of options granted and outstanding as of July 2, 2016 and July 4, 2015 was $0.55 and $0.54, respectively. 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 the balance sheet and the exercise price. During the twenty-six weeks ended July 2, 2016 and July 4, 2015, the options had $0 intrinsic value. The Company had $325 of unrecognized share-based compensation expense related to stock options outstanding as of July 2, 2016, which expense is expected to be recognized over a weighted-average period of 2.69 years.

Options exercised under all share-based compensation plans are granted net of the minimum statutory withholding requirements that we pay in cash to the appropriate taxing authorities on behalf of our employees. For those employees who elect not to receive shares net of the minimum statutory withholding requirements, the appropriate taxes are paid directly by the employee. During the thirteen and twenty-six weeks ended July 2, 2016, we withheld 0 shares to satisfy $0 of employees' tax obligations and 0 shares related to the net settlement of the stock options.

U.S. Auto Parts Network Options and Restricted Stock Units

The Company had the following common stock option activity during the twenty-six weeks ended July 2, 2016:

•Granted options to purchase 925 common shares.

•Forfeitures of 17 options to purchase common shares.

•Expiration of 26 options to purchase common shares.

The following table summarizes the Company’s restricted stock unit ("RSU") activity for the twenty-six weeks ended July 2, 2016, and details regarding the awards outstanding and exercisable at July 2, 2016 (in thousands):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Awards outstanding, January 2, 2016	804	$ —		
Awarded	954	$ —		
Vested	(774)	$ —		
Forfeited	(3)	$ —		
Awards outstanding, July 2, 2016	981	$ —	1.00	$ 3,904
Vested and expected to vest at July 2, 2016	878	$ —	0.96	$ 3,493

During the twenty-six weeks ended July 2, 2016, all RSU's that vested were time-based. For the majority of RSUs awarded, the number of shares issued on the date the RSUs vest is net of the minimum statutory withholding requirements that we pay in cash to the appropriate taxing authorities on behalf of our employees. For those employees who elect not to receive shares net of the minimum statutory withholding requirements, the appropriate taxes are paid directly by the employee. During the twenty-six weeks ended July 2, 2016, we withheld 131 shares to satisfy $371 of employees' tax obligations. Although shares withheld are not issued, they are treated as a common stock repurchase in our consolidated financial statements, as they reduce the number of shares that would have been issued upon vesting.

For the thirteen and twenty-six weeks ended July 2, 2016, we recorded compensation expense of $889 and $1,717, respectively. As of July 2, 2016, there was unrecognized compensation expense of $1,355 related to unvested RSUs based on awards that are expected to vest. The unrecognized compensation expense is expected to be recognized over a weighted-average period of 1 year.

Note 5 – Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share data):

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Net income (loss) per share:				
Numerator:				
Net income (loss) attributable to U.S. Auto Parts	$934	$(775)	2,186	(835)
Dividends on Series A Convertible Preferred Stock	60	60	120	120
Net income (loss) available to common shares	$874	$(835)	$2,066	$(955)
Denominator:				
Weighted-average common shares outstanding (basic)	34,753	33,963	34,625	33,842
Common equivalent shares from common stock options, preferred stock and warrants	5,254	—	5,030	—
Weighted-average common shares outstanding (diluted)	40,007	33,963	39,655	33,842
Basic net income (loss) per share	$0.03	$(0.02)	$0.06	$(0.03)
Diluted net income (loss) per share	$0.02	$(0.02)	$0.05	$(0.03)

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Common stock warrants	20	50	20	50
Series A Convertible Preferred Stock	—	4,150	—	4,150
Restricted stock units	981	867	969	850
Options to purchase common stock	2,141	6,044	2,393	5,878
Total	3,142	11,111	3,382	10,928

Note 6 – Income Taxes

The Company is subject to U.S. federal income tax as well as income tax of foreign and state tax jurisdictions. The tax years 2011-2015 remain open to examination by the major taxing jurisdictions to which the Company is subject, except the Internal Revenue Service for which the tax years 2012-2015 remain open.

For the thirteen and twenty-six weeks ended July 2, 2016 the effective tax rate for the Company was 9.0% and 14.0%, respectively. The Company's effective tax rate for the thirteen and twenty-six weeks ended July 2, 2016 differed from the U.S. federal statutory rate primarily as a result of the recording of valuation allowance against the pre-tax losses that was offset by the tax benefit resulting from the reduction of excess book basis in the Company's investment in AutoMD over its tax basis due to AutoMD's pre-tax losses. For the thirteen and twenty-six weeks ended July 4, 2015, the effective tax rate for the Company was 25.3% and 23.0%, respectively. The Company’s effective tax rate for the thirteen and twenty-six weeks ended July 4, 2015 differed from the U.S. federal statutory rate primarily as a result of

the recording of valuation allowance against the pre-tax losses.

Note 7 – Commitments and Contingencies

Facilities Leases

The Company's corporate headquarters is located in Carson, California, and has a lease term through October 2020. The Company also leases warehouse space in LaSalle, Illinois and in Chesapeake, Virginia. The Company's Philippines subsidiary leases office space under an agreement through April 2020.

Facility rent expense for the thirteen and twenty-six weeks ended July 2, 2016 was $402 and $804, respectively, compared to $399 and $764 for the thirteen and twenty-six weeks ended July 4, 2015, respectively.

Minimum lease commitments under non-cancellable operating leases as of July 2, 2016 were as follows (in thousands):

2016	$833
2017	1,652
2018	1,672
2019	1,250
2020	542
2021 onwards	$—
Total	$5,949

Capital lease commitments as of July 2, 2016 were as follows (in thousands):

2016	$639
2017	1,311
2018	1,319
2019	1,304
2020	1,130
2021 onwards	12,910
Total minimum payments required	18,613
Less amount representing interest	8,027
Present value of minimum capital lease payments	$10,586

Legal Matters

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

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

Note 8 – Segment information

As described in Note 1 above, the Company operates in two reportable segments identified as Base USAP, which is the core auto parts business, and AutoMD, an online automotive repair source of which the Company is a majority stockholder. Segment information is prepared on the same basis that our chief executive officer, who is our chief operating decision maker, manages the segments, evaluates financial results, and makes key operating decisions. Management evaluates the performance of its operating segments based on net sales, gross profit and income (loss) from operations. Operating income (loss) represents earnings (loss) before other income, interest expense and income taxes. The identifiable assets by segment disclosed in this note are those assets specifically identifiable within each segment.

12

Summarized segment information for our continuing operations from the two reportable segments for the periods presented is as follows (in thousands):

	Base USAP	AutoMD	Consolidated
Thirteen weeks ended July 2, 2016			
Net sales	$ 77,999	$ 56	$ 78,055
Gross profit	$ 23,701	$ 53	$ 23,754
Operating costs (1)	$ 22,132	$ 757	$ 22,889
Income (loss) from operations	$ 1,569	$ (704)	$ 865
Capital expenditures	$ 1,350	$ 261	$ 1,611
Depreciation and amortization	$ 1,556	$ 297	$ 1,853
Total assets, net	$ 71,944	$ 4,274	$ 76,218
Thirteen weeks ended July 4, 2015			
Net sales	$ 76,411	$ 51	$ 76,462
Gross profit	$ 20,817	$ 51	$ 20,868
Operating costs (1)	$ 21,235	$ 740	$ 21,975
Income (loss) from operations	$ (418)	$ (689)	$ (1,107)
Capital expenditures	$ 1,373	$ 308	$ 1,681
Depreciation and amortization	$ 1,484	$ 338	$ 1,822
Total assets, net	$ 70,918	$ 7,197	$ 76,218
Twenty-six weeks ended July 2, 2016			
Net sales	$ 158,745	$ 116	$ 158,861
Gross profit	$ 48,233	$ 113	$ 48,346
Operating costs (1)	$ 44,753	$ 1,546	$ 46,299
Income (loss) from operations	$ 3,480	$ (1,433)	$ 2,047
Capital expenditures	$ 2,355	$ 532	$ 2,887
Depreciation and amortization	$ 3,100	$ 604	$ 3,704
Total assets, net	$ 71,944	$ 4,274	$ 76,218
Twenty-six weeks ended July 4, 2015			
Net sales	$ 152,736	$ 114	$ 152,850
Gross profit	$ 42,232	$ 114	$ 42,346
Operating costs (1)	$ 41,955	$ 1,516	$ 43,471
Loss from operations	$ 277	$ (1,402)	$ (1,125)
Capital expenditures	$ 3,338	$ 494	$ 3,832
Depreciation and amortization	$ 3,033	$ 723	$ 3,756
Total assets, net	$ 70,918	$ 7,197	$ 78,115

(1) Operating costs for AutoMD primarily consist of depreciation and amortization on fixed assets and personnel costs. Indirect costs are not allocated to AutoMD.

The following table summarizes the approximate distribution of Base USAP revenue by product type.

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Private Label				
Collision	50%	46%	51%	48%
Engine	14%	14%	15%	13%
Performance	1%	1%	1%	1%

Branded				
Collision	2%	2%	2%	2%
Engine	13%	15%	12%	14%
Performance	20%	22%	19%	22%
Total	100%	100%	100%	100%

Note 9 – AutoMD

On October 8, 2014, AutoMD entered into a Common Stock Purchase Agreement ("Purchase Agreement") to sell an aggregate of 7,000 shares of AutoMD common stock at a purchase price of $1.00 per share to third-party investors and investors that are affiliated with two of our board members. The Company retained 64.1% of AutoMD's outstanding common stock, and continues to consolidate AutoMD.

In connection with the sale of the shares of AutoMD, the Company recorded an increase to additional paid-in-capital of $2,534. This amount is equal to the increase in the Company's interest in the net assets of AutoMD, resulting from this sale of common shares valued at $3,847, less the related deferred tax liability of $1,313.

Additionally, pursuant to the terms of the Purchase Agreement, the Company may be required to purchase 2,000 shares of AutoMD common stock at a purchase price of $1.00 per share, with such purchase to be triggered only if as of October 8, 2016, AutoMD does not meet a required minimum number of approved auto repair shops permitted to submit a quotation on AutoMD's website ("Registered Repair Shops"), or separately if at any time during the two years following the closing date AutoMD fails to meet specified minimum cash balances and minimum numbers of Registered Repair Shops. AutoMD is commencing with charging repair shops a subscription fee during the third quarter, and as a result, we expect to fall below the minimum number of Registered Repair Shops as of October 8, 2016. The Purchase Agreement also limits the use of the $7,000 in proceeds from the sale of AutoMD common stock to only general operating purposes of AutoMD. The Company cannot use or borrow any of the proceeds without the approval of AutoMD's Board of Directors.

In addition to the Purchase Agreement, AutoMD entered into an Investor Rights Agreement. The Investor Rights Agreement includes certain demand and piggyback registration rights, and restrictions on transfers or dilutive transactions involving AutoMD common stock. Prior to October 8, 2017, the Company is prohibited from transferring shares of AutoMD owned by U.S. Auto Parts or enter into any transaction or arrangement (including, without limitation, any sale, gift, merger or consolidation) that would result in U.S. Auto Parts owning, at any time, less than 50% of the shares of capital stock of the Company without the prior written consent of AutoMD shareholders. In the event of a proposed transfer or dilutive transaction for which any shareholder does not provide its written consent, in the alternative, upon not less than 30 days prior written notice to such non-consenting party, the Company may elect, at its sole option, to purchase all shares of the AutoMD common stock then owned by any non-consenting shareholder at a purchase price equal to $1.00 per share (as adjusted for any stock combinations, splits, recapitalizations, etc.) plus an annual rate of 10% thereon, compounded annually, and effect such transfer.

The table below presents the effect of changes in the Company's ownership interest in AutoMD on the Company's equity during the twenty-six weeks ended July 2, 2016:

	Noncontrolling Interest
Balance, January 2, 2016	$ 1,803
Net loss allocable to noncontrolling interest	(515)
Balance, July 2, 2016	$ 1,288

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (In Thousands, Except Per Share Data, Or As Otherwise Noted)

Cautionary Statement

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

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

Overview

We are a leading online provider of aftermarket auto parts, including collision parts, engine parts, and performance parts and accessories. Our user-friendly websites provide customers with a broad selection of stock keeping units ("SKUs"), with detailed product descriptions and photographs. Our proprietary product database maps our SKUs to product applications based on vehicle makes, models and years. We principally sell our products to individual consumers through our network of websites and online marketplaces. Through AutoMD.com, our majority-owned subsidiary, the Company also educates consumers on the maintenance and service of their vehicles. Our flagship consumer websites are located at www.autopartswarehouse.com, www.carparts.com, www.jcwhitney.com and www.AutoMD.com and our corporate website is located at www.usautoparts.net.

We believe our strategy of disintermediating the traditional auto parts supply chain and selling products directly to customers over the Internet allows us to efficiently deliver products to our customers. Industry-wide trends that support our strategy include:

1. Number of SKUs required to serve the market. The number of automotive SKUs has grown dramatically over the last several years. In today's market, unless the consumer is driving a high volume produced vehicle and needs a simple maintenance item, the part they need is not typically on the shelf at a brick-and-mortar store. We believe our user-friendly websites provide customers with a favorable alternative to the brick-and-mortar shopping experience by offering a comprehensive selection of over 1.0 million SKUs with detailed product descriptions, attributes and photographs combined with the flexibility of fulfilling orders using both drop-ship and stock-and-ship methods.

2.U.S. vehicle fleet expanding and aging. The average age of U.S. vehicles, an indicator of auto parts demand, rose to a record-high 11.5 years as of January 2015, according to IHS Automotive, a market analytics firm that expects the average age to remain at, or near record-highs through 2020. IHS expects the number of vehicles that are 12 years or older to increase by 15% by 2020. IHS found that the total number of light vehicles in operation in the U.S. has increased to record levels, with new vehicle registrations outpacing scrappage rates by more than 42%. We believe an increasing vehicle base and rising average age of vehicles will have a positive impact on overall aftermarket parts demand because older vehicles generally require more repairs. In many cases we believe these older vehicles are driven by do-it-yourself ("DIY") car owners who are more likely to handle any necessary repairs themselves rather than taking their car to the professional repair shop.

3.Growth of online sales. Management estimates that overall revenue from online sales of auto parts and accessories is projected to increase from approximately $5.5 billion in 2015 to $9.7 billion in 2018. Improved product availability, lower prices and consumers' growing comfort with digital platforms are driving the shift to online sales. We believe that we are well positioned for the shift to online sales due to our history of being a leading source for aftermarket automotive parts through online marketplaces and our network of websites.

Our History. We were formed in California in 1995 as a distributor of aftermarket auto parts and launched our first website in 2000. We reincorporated in Delaware in 2006 and expanded our online operations, increasing the number of SKUs sold through our e-commerce network, adding additional websites, improving our Internet marketing proficiency and commencing sales in online marketplaces. Additionally, in August 2010, through our acquisition of Whitney Automotive Group, Inc. (referred to herein as "WAG"), we expanded our product-lines and increased our customer reach in the DIY automobile and off-road accessories market.

International Operations. In April 2007, we established offshore operations in the Philippines. Our offshore operations allow us to access a workforce with the necessary technical skills at a significantly lower cost than comparably

experienced U.S.-based professionals. Our offshore operations are responsible for a majority of our website development, catalog management, and back office support. Our offshore operations also house our main call center. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a cost-effective manner.

AutoMD. In October 2014, AutoMD entered into a common stock purchase agreement to sell seven million shares of AutoMD common stock at a purchase price of $1.00 per share to third-party investors, reducing the Company's ownership interest in AutoMD to 64.1%.

AutoMD's mission is to be the repair shop advocate for all vehicle owners, increase their confidence in the repair process and provide the most affordable and high quality options for automobile repair. AutoMD's focus has been on marketing and technology. AutoMD's marketing strategy has involved driving growth in their repair shop network. During the first half of 2016, marketing efforts resulted in approximately 2,760 repair shops joining AutoMD's network, rising from about 3,220 repair shops in December 2015 to over 5,000 at the end of the second quarter of 2016. AutoMD is commencing with charging repair shops a subscription fee during the third quarter, and as a result, we expect the number of repair shops to decline below 5,000 as of October 8, 2016. As such, we would be required to purchase 2.0 million shares of AutoMD common stock at a purchase price of $1.00 per share under the terms of the purchase agreement entered into with AutoMD and third party investors. In addition to marketing, AutoMD continues to refine the online experience, including its mobile presence.

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Unique Visitors (millions) [1]	30.2	29.2	61.6	59.8
E-commerce Orders (thousands)	544	523	1,103	1,039
Online Marketplace Orders (thousands)	315	276	637	572
Total Online Orders (thousands)	859	799	1,740	1,611
E-commerce Average Order Value	$ 109	$ 112	$108	$111
Online Marketplace Average Order Value	$ 71	$ 71	$72	$71
Total Online Average Order Value	$ 95	$ 98	$95	$97
Revenue Capture [1]	84.0 %	85.7 %	84.7 %	85.6 %
Conversion [1]	1.8 %	1.8 %	1.8 %	1.7 %

[1] Excludes online marketplaces and media properties (e.g. AutoMD).

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. Included in the unique visitors are mobile device based customers, who are becoming an increasing part of our business. Shifting consumer behavior and technology enhancements indicates that customers are becoming more inclined to purchase auto parts through their mobile devices. User sophistication and technological advances have increased consumer expectations around the user experience on mobile devices, including speed of response, functionality, product availability, security, and ease of use. We believe enhancements to online solutions specifically catering to mobile based shopping can result in an increase in the number of orders and revenues. We believe an increase in unique visitors to our websites will result in an increase in the number of orders. We seek to increase the number of unique visitors to our websites by attracting repeat customers and improving search engine marketing and other internet marketing activities. During the thirteen and twenty-six weeks ended July 2, 2016 our unique visitors increased by 3.4% and 3.0%, respectively, compared to the same periods of 2015 primarily due to an increase in paid traffic, partially offset by a decrease in organic traffic.

Total Number of Orders: We monitor the total number of orders as an indicator of future revenue trends. Total orders increased 7.5% in the second quarter of 2016 compared to the second quarter of 2015, with e-commerce and online

marketplace orders increasing by 4.0% and 14.1%, respectively. Total orders were up 8.0% in the YTD Q2 2016, compared to the YTD Q2 2015, with e-commerce and online marketplace orders increasing by 6.2% and 11.4%, respectively. We believe that e-commerce and online marketplace orders improved YTD Q2 2016 through an enhanced customer experience, greater product selection and certain strategic pricing initiatives. 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. Average order value decreased 3.1% and 2.1%, respectively, in the second quarter and YTD Q2 2016 compared to the same periods of 2015 primarily due to a mix shift towards more private label sales. 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 online competition.
Revenue Capture: Revenue capture is the amount of actual dollars retained after taking into consideration returns, credit card declines and product fulfillment. During the second quarter and YTD Q2 2016, our revenue capture decreased by 2.0% and 1.1%, respectively, compared to the same periods of 2015.
Conversion: Conversion is the number of orders as a rate of the total number of unique visitors. This rate indicates how well we convert a visitor to a customer sales order. During the YTD Q2 2016, our conversion improved to 1.8% compared to 1.7% in the same period of 2015.
Executive Summary
For the second quarter of 2016, Base USAP generated net sales of $77,999, compared with $76,411 for the second quarter of 2015, representing an increase of 2.1%. Base USAP net income for the second quarter of 2016 was $1,216, compared to net loss of $611 for the second quarter of 2015. We generated income before interest expense, net, income tax provision, depreciation and amortization expense, amortization of intangible assets, plus share-based compensation expense and restructuring costs (“Adjusted EBITDA”) of $4,025 in the second quarter of 2016 compared to $1,757 in the second quarter of 2015. Adjusted EBITDA, which is not a Generally Accepted Accounting Principle measure, is presented because such measure is used by rating agencies, securities analysts, investors and other parties in evaluating the Company. It should not be considered, however, as an alternative to operating income, as an indicator of the Company’s operating performance, or as an alternative to cash flows, as measures of the Company’s overall liquidity, as presented in the Company’s consolidated financial statements. Further, the Adjusted EBITDA measure shown may not be comparable to similarly titled measures used by other companies. Refer to the table presented below under "Non-GAAP measures" for additional information and a reconciliation of net income (loss) to Adjusted EBITDA.
For the second quarter of 2016, AutoMD generated net sales of $56 compared to $51 in the same period last year. AutoMD's net loss was $535 for the second quarter of 2016 compared to a net loss of $411 for the second quarter of 2015. AutoMD's Adjusted EBITDA was negative $317 compared to negative $321 in the same period last year.
Our second quarter 2016 net sales consisted of online sales, representing 91.5% of the total (compared to 90.8% in the second quarter of 2015), and offline sales, representing 8.5% of the total (compared to 9.2% in the second quarter of 2015). The net sales increase was due to an increase of $1,946, or 2.8%, in online sales, partially offset by a decrease in offline sales of $360, or 5.1%. The online sales channels increase is primarily the result of a $2,830, or 15.9%, increase in our online market places partially offset by a $571, or 1.0%, decrease in our e-commerce sales channel. The increase in our online marketplaces sales channels was driven by increased conversion rates.

Like most e-commerce retailers, our success depends on our ability to attract online consumers to our websites and convert them into customers in a cost-effective manner. Historically, marketing through search engines provided the most efficient opportunity to reach millions of on-line auto part buyers. We are included in search results through paid search listings, where we purchase specific search terms that will result in the inclusion of our listing, and algorithmic searches that depend upon the searchable content on our websites. Algorithmic listings cannot be purchased and instead are determined and displayed solely by a set of formulas utilized by the search engine. We have had a history of success with our search engine marketing techniques, which gave our different websites preferred positions in search results. Search engines, like Google, revise their algorithms from time to time in an attempt to optimize their search results. During the last few years, Google has changed its search results ranking algorithm. In some cases our unique visitor count, and therefore our financial results, were negatively impacted by these changes. While we continue to address the ongoing changes to the Google methodology, during the second quarter of 2016, our unique visitor count increased by 1.0 million, or 3.4%, to 30.2 million unique visitors compared to 29.2 million unique

visitors in the second quarter of 2015 primarily due an increase in paid traffic, partially offset by lower organic traffic. As in the past we expect Google will continue to make changes in their search engine algorithms to improve their user experience. As we are significantly dependent upon search engines for our website traffic, if we are unable to attract unique visitors, our business and results of operations will be harmed.

Total orders increased for the second quarter of 2016 compared to the second quarter of 2015, while our average order value decreased for the same period. Total expenses, which primarily consisted of cost of sales and operating costs, decreased

during the second quarter of 2016 compared to the same period in 2015. Components of our cost of sales and operating costs are described in further detail under — "Results of Operations" below.

We made positive strides towards achieving our strategic goals during fiscal year 2015 and during the first half of fiscal year 2016. We continue to pursue strategies to support our positive sales growth and improve gross profit while reducing operating costs as percent of sales:

- We expect to continue positive e-commerce growth by providing unique catalog content and providing better content on our websites with the goal of improving our ranking on the search results. In addition, we intend to improve mobile enabled websites to take advantage of shifting consumer behaviors. We expect revenue trends to remain positive for the remainder of 2016.
- We continue to work to improve the website purchase experience for our customers by (1) helping our customers find the parts they want to buy by reducing failed searches and increasing user purchase confidence; (2) implementing guided navigation and custom buying experiences specific to strategic part names; and (3) increasing order size across our sites through improved recommendation engines. In addition, we intend to build mobile enabled websites to take advantage of shifting consumer behaviors. These efforts may increase the conversion rate of our visitors to customers, the total number of orders and average order value, and the number of repeat purchases, as well as contribute to our revenue growth.
- We continue to work towards becoming one of the preferred low price options in the market for aftermarket auto parts and accessories. We also continue to offer lower prices by increasing foreign sourced private label products as they are generally less expensive and we believe provide better value for the consumer. We believe our product offering will improve the conversion rate of visitors to our website, grow our revenues and improve our margins.
- We continue to increase product selection by being the first to market with many new SKUs. We currently have over 55,000 private label SKUs and over 1.0 million branded SKUs in our product selection. We will seek to add new categories and expand our existing specialty categories. We believe continued product expansion will increase the total number of orders and contribute to our revenue growth. Additionally, we plan to continue to maintain certain in-stock inventory throughout the year to ensure consistent service levels and improve customer experience.
- We are the consumer advocate for auto repair through AutoMD.com. We will continue to devote resources to AutoMD.com, its system development and the expansion of its repair shop network, drawing upon the proceeds from the sale of AutoMD common stock. We believe this resource allocation will help improve our brand recognition and contribute to our long-term revenue growth.
- We continue to implement cost saving measures.

Overall, we expect continued revenue growth in fiscal year 2016 compared to fiscal year 2015 due to the initiatives we have implemented and will implement through the remainder of our fiscal year.

We have redesigned our approach to attracting customers through search engines with increased paid advertising which has helped us offset some of the decline in organic traffic to our e-commerce sites. We have also continued to pursue revenue opportunities in third-party online marketplaces, a number of which continue to grow each year. Auto parts buyers are finding third-party online marketplaces to be a very attractive environment, for many reasons, the top five being: (1) the security of their personal information; (2) the ability to easily compare product offerings from multiple sellers; (3) transparency (consumers can leave positive or negative feedback about their experience); (4) favorable pricing; and (5) the availability of products not found in stock at brick-and-mortar stores. Successful selling in these third-party online marketplaces depends on product innovation, and strong relationships with suppliers, both of which we believe to be our core competencies.

Non-GAAP measures

Regulation G, “Conditions for Use of Non-GAAP Financial Measures,” and other provisions of the Securities Exchange Act of 1934, as amended, define and prescribe the conditions for use of certain non-GAAP financial information. We provide EBITDA and Adjusted EBITDA, which are non-GAAP financial measures. EBITDA consists of net income (loss) before (a) interest expense, net; (b) income tax provision; (c) depreciation and amortization expense; and (d) amortization of intangible assets; while Adjusted EBITDA consists of EBITDA before (a) share-based compensation expense; and (b) restructuring costs.

The Company believes that these non-GAAP financial measures provide important supplemental information to management and investors. These non-GAAP financial measures reflect an additional way of viewing aspects of the Company’s operations that, when viewed with the GAAP results and the accompanying reconciliation to corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting the Company’s business and results of operations.

Management uses Adjusted EBITDA as one measure of the Company’s operating performance because it assists in comparing the Company’s operating performance on a consistent basis by removing the impact of stock compensation expense, as well as items that are not expected to be recurring. Internally, this non-GAAP measure is also used by management for planning purposes, including the preparation of internal budgets; for allocating resources to enhance financial performance; and for evaluating the effectiveness of operational strategies. The Company also believes that analysts and investors use Adjusted EBITDA as a supplemental measure to evaluate the ongoing operations of companies in our industry.

This non-GAAP financial measure is used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial measures. Management strongly encourages investors to review the Company’s consolidated financial statements in their entirety and to not rely on any single financial measure. Because non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies’ non-GAAP financial measures having the same or similar names. In addition, the Company expects to continue to incur expenses similar to the non-GAAP adjustments described above, and exclusion of these items from the Company’s non-GAAP measures should not be construed as an inference that these costs are unusual, infrequent or non-recurring.

The Company operates in two reportable segments identified as the core auto parts business ("Base USAP"), and AutoMD, an online automotive repair source of which the Company is a majority stockholder. Segment information is prepared on the same basis that our chief executive officer, who is our chief operating decision maker, manages the segments, evaluates financial results, and makes key operating decisions. Management evaluates the performance of its two operating segments based on net sales, gross profit and loss from operations. The accounting policies of the operating segments are the same as those described in “Note 1 - Summary of Significant Accounting Policies and Nature of Operations” of our Notes to Consolidated Financial Statements. Operating income represents earnings before other income, interest expense and income taxes. The identifiable assets by segment disclosed are those assets specifically identifiable within each segment.

Summarized segment information for our continuing operations from the two reportable segments for the periods presented is as follows (in thousands):

	Thirteen Weeks Ended					
	July 2, 2016			July 4, 2015		
	Base USAP	AMD	Consolidated	Base USAP	AMD	Consolidated
Net sales	$77,999	$56	$ 78,055	$76,411	$51	$ 76,462
Cost of sales	54,298	3	54,301	55,594	—	55,594
Gross profit	23,701	53	23,754	20,817	51	20,868
Operating expenses:						
Marketing	10,424	622	11,046	10,472	676	11,148
General and administrative	4,540	86	4,626	4,441	43	4,484
Fulfillment	5,658	—	5,658	4,978	—	4,978
Technology	1,397	41	1,438	1,237	13	1,250
Amortization of intangible assets	113	8	121	107	8	115
Total operating expenses	22,132	757	22,889	21,235	740	21,975
Income (loss) from operations	1,569	(704)	865	(418)	(689)	(1,107)
Other income (expense):						
Other income, net	11	—	11	10	—	10
Interest expense	(251)	—	(251)	(272)	—	(272)
Total other expense	(240)	—	(240)	(262)	—	(262)
Income (loss) before income taxes	1,329	(704)	625	(680)	(689)	(1,369)
Income tax (benefit) provision	113	(169)	(56)	(69)	(278)	(347)
Net income (loss)	$1,216	$(535)	$ 681	$(611)	$(411)	$ (1,022)
Net income (loss)	$1,216	$(535)	$ 681	$(611)	$(411)	$ (1,022)
Depreciation & amortization	1,556	297	1,853	1,484	338	1,822
Amortization of intangible assets	113	8	121	107	8	115
Interest expense, net	242	—	242	272	—	272
Taxes	113	(169)	(56)	(69)	(278)	(347)
EBITDA	$3,240	$(399)	$ 2,841	$1,183	$(343)	$ 840
Stock comp expense	$785	$82	$ 867	$574	$22	$ 596
Adjusted EBITDA	$4,025	$(317)	$ 3,708	$1,757	$(321)	$ 1,436
Capital expenditures	1,350	261	1,611	1,373	308	1,681
Total assets, net of accumulated depreciation	71,944	4,274	76,218	70,918	7,197	78,115

	Twenty-Six Weeks Ended					
	July 2, 2016			July 4, 2015		
	Base USAP	AMD	Consolidated	Base USAP	AMD	Consolidated
Net sales	$158,745	$116	$ 158,861	$152,736	$114	$ 152,850
Cost of sales	110,512	3	110,515	110,504	—	110,504
Gross profit	48,233	113	48,346	42,232	114	42,346
Operating expenses:						
Marketing	21,218	1,318	22,536	20,662	1,338	22,000
General and administrative	8,973	138	9,111	8,564	101	8,665
Fulfillment	11,696	—	11,696	10,038	—	10,038
Technology	2,641	74	2,715	2,477	61	2,538
Amortization of intangible assets	225	16	241	214	16	230
Total operating expenses	44,753	1,546	46,299	41,955	1,516	43,471
Income (loss) from operations	3,480	(1,433)	2,047	277	(1,402)	(1,125)
Other income (expense):						
Other income (expense), net	17	—	17	33	—	33
Interest expense	(598)	—	(598)	(645)	—	(645)
Total other expense	(581)	—	(581)	(612)	—	(612)
Loss before income taxes	2,899	(1,433)	1,466	(335)	(1,402)	(1,737)
Income tax provision (benefit)	146	(351)	(205)	89	(488)	(399)
Net income (loss)	$2,753	$(1,082)	$ 1,671	$(424)	$(914)	$ (1,338)
Net income (loss)	$2,753	$(1,082)	$ 1,671	$(424)	$(914)	$ (1,338)
Depreciation & amortization	3,100	604	3,704	3,033	723	3,756
Amortization of intangible assets	225	16	241	214	16	230
Interest expense, net	588	—	588	645	—	645
Taxes	146	(351)	(205)	89	(488)	(399)
EBITDA	$6,812	$(813)	$ 5,999	$3,557	$(663)	$ 2,894
Stock comp expense	$1,557	$111	$ 1,668	$1,051	$55	$ 1,106
Adjusted EBITDA	$8,369	$(702)	$ 7,667	$4,608	$(608)	$ 4,000
Capital expenditures	2,355	532	2,887	3,338	494	3,832
Total assets, net of accumulated depreciation	71,944	4,274	76,218	70,918	7,197	78,115

Results of Operations

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	69.6	72.7	69.6	72.3
Gross profit	30.4	27.3	30.4	27.7
Operating expenses:				
Marketing	14.2	14.5	14.2	14.4
General and administrative	5.9	5.9	5.7	5.7
Fulfillment	7.2	6.5	7.4	6.5
Technology	1.8	1.6	1.7	1.7
Amortization of intangible assets	0.2	0.2	0.2	0.1
Total operating expenses	29.3	28.7	29.2	28.4
Income from operations	1.1	(1.4)	1.2	(0.7)
Other income (expense):				
Other income, net	—	—	—	—
Interest expense	(0.3)	(0.4)	(0.4)	(0.4)
Total other expense, net	(0.3)	(0.4)	(0.4)	(0.4)
Income (loss) before income taxes	0.8	(1.8)	0.8	(1.1)
Income tax provision (benefit)	(0.1)	(0.5)	(0.1)	(0.3)
Net income (loss) including noncontrolling interests	0.9 %	(1.3)%	0.9 %	(0.8)%

Thirteen and twenty-six weeks Ended July 2, 2016 Compared to the Thirteen and twenty-six weeks Ended July 4, 2015

Net Sales and Gross Margin

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(in thousands)			
Net sales	$78,055	$76,462	$158,861	$152,850
Cost of sales	54,301	55,594	110,515	110,504
Gross profit	$23,754	$20,868	$48,346	$42,346
Gross margin	30.4 %	27.3 %	30.4 %	27.7 %

Net sales increased $1,593, or 2.1%, for the second quarter of 2016 compared to the second quarter of 2015. Our net sales consisted of online sales, representing 91.5% of the total for the second quarter of 2016 (compared to 90.8% in the second quarter of 2015), and offline sales, representing 8.5% of the total for the second quarter of 2016 (compared to 9.2% in the second quarter of 2015). The net sales increase was driven by an increase of $1,946, or 2.8%, in online sales. Online sales increased primarily due to an increase in total online orders of 7.5%, which resulted from an increase in unique visitors of 3.4%. In the second quarter of 2016, our offline sales, which consist of our Kool-Vue™ and wholesale operations, decreased by $360, or 5.1%, compared to the second quarter of 2015, primarily due to a decline in wholesale operations, partially offset by increased Kool-Vue™ sales.

Net sales increased $6,011, or 3.9%, for the twenty-six weeks ended July 2, 2016 ("YTD Q2 2016") compared to the

twenty-six weeks ended July 4, 2015 ("YTD Q2 2015"). Our net sales consisted of online sales, representing 91.1% of the total net sales for YTD Q2 2016 (compared to 90.6% for YTD Q2 2015), and offline sales, representing 8.9% of the total for YTD Q2 2016 (compared to 9.4% for YTD Q2 2015). The net sales increase was driven by an increase of $6,186, or 4.5%, in online sales. Online sales increased primarily due to an increase in both conversion and traffic, partially offset by a decrease

in revenue capture. During YTD Q2 2016 our offline sales, which consist of our Kool-Vue™ and wholesale operations, decreased by $182, or 1.3%, compared to YTD Q2 2015, primarily due to a decline in wholesale operations, partially offset by increased Kool-Vue™ sales.

Gross profit increased $2,886 or 13.8%, compared to the second quarter of 2015 and increased $6,000 or 14.2%, compared to YTD Q2 2015. Gross margin rate increased 3.1% to 30.4% in the second quarter of 2016 compared to 27.3% in the second quarter of 2015, and increased 2.7% to 30.4% in YTD Q2 2016 compared to 27.7% in YTD Q2 2015. Gross margin rate increased for both the second quarter and YTD Q2 2016 primarily due to a favorable mix shift of private label sales compared to last year as well as strategic pricing initiatives, freight efficiencies and lower shipping supply costs.

Marketing Expense

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(in thousands)			
Marketing expense	$11,046	$11,148	$22,536	$22,000
Percent of net sales	14.2 %	14.5 %	14.2 %	14.4 %

Total marketing expense decreased $102, or 0.9%, for the second quarter of 2016 compared to the second quarter of 2015. Online advertising expense, which includes catalog costs, was $5,768, or 8.1%, of online sales compared to $5,330, or 7.7%, of online sales for the prior year period. Online advertising expense increased in the second quarter of 2016 primarily due to our non-catalog online adverting expenses, which includes listing and placement fees paid to commercial and search engine websites, of $5,478, or 7.0%, of net sales compared to $4,881, or 6.4% of net sales in the second quarter of 2015. This increase relates primarily to the greater mix of paid traffic compared to organic traffic. Marketing expense, excluding online advertising, was $5,273, or 6.8%, of net sales compared to $5,816, or 7.6%, of net sales for the same period last year. The decrease was primarily due to a decrease in depreciation and amortization of $267. As a percent of net sales, total marketing expense during the second quarter of 2016 decreased compared to the second quarter of 2015.

Total marketing expense increased $536, or 2.4%, for YTD Q2 2016 compared to YTD Q2 2015. Online advertising expense, which includes catalog costs, was $11,770, or 8.1%, of online sales compared to $10,307, or 7.4%, of online sales for the prior year period. Online advertising expense increased in YTD Q2 2016 primarily due to our non-catalog online adverting expenses, which includes listing and placement fees paid to search engine websites, of $11,204, or 7.1%, of net sales compared to $9,454, or 6.2% of net sales in YTD Q2 2015. This increase relates primarily to the greater mix of paid traffic compared to organic traffic. Marketing expense, excluding online advertising, was $10,761, or 6.8%, of net sales compared to $11,692, or 7.6%, of net sales for the same period last year. The decrease was primarily due to a decrease in depreciation and amortization of $693. As a percent of net sales, total marketing expense during YTD Q2 2016 decreased slightly compared to YTD Q2 2015.

General and Administrative Expense

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(in thousands)			
General and administrative expense	$4,626	$4,484	$9,111	$8,665
Percent of net sales	5.9 %	5.9 %	5.7 %	5.7 %

General and administrative expense increased $142, or 3.2%, for the second quarter of 2016 and increased $446, or 5.1%, for YTD Q2 2016 compared to the same periods in 2015, but remained consistent as a percentage of net sales compared to the prior periods.

23

Fulfillment Expense

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(in thousands)			
Fulfillment expense	$5,658	$4,978	$11,696	$10,038
Percent of net sales	7.2 %	6.5 %	7.4 %	6.5 %

Fulfillment expense increased $680, or 13.7%, and $1,658, or 16.5%, for the second quarter of 2016 and YTD Q2 2016, respectively, compared to the same periods in 2015 primarily due to increased fixed and variable wages, as well as increased depreciation and amortization.

Technology Expense

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(in thousands)			
Technology expense	$1,438	$1,250	$2,715	$2,538
Percent of net sales	1.8 %	1.6 %	1.7 %	1.7 %

Technology expense increased $188, or 15.0%, and $177, or 7.0%, for the second quarter of 2016 and YTD Q2 2016, respectively, compared to the same periods in 2015, primarily due to increased fixed and variable wages, as well as increased overhead.

Total Other Expense, Net

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(in thousands)			
Other expense, net	$(240)	$(262)	$(581)	$(612)
Percent of net sales	(0.3)%	(0.4)%	(0.4)%	(0.4)%

Total other expense, net decreased $22, or 8.4%, and $31, or (5.1)%, for the second quarter of 2016 and YTD Q2 2016, respectively, compared to the same periods in 2015. The decrease was primarily due to lower loan interest costs due to a lower revolver balance.

Income Tax Provision

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(in thousands)			
Income tax (benefit) provision	$(56)	$(347)	$(205)	$(399)
Percent of net sales	(0.1)%	(0.5)%	(0.1)%	(0.3)%

For the thirteen and twenty-six weeks ended July 2, 2016, the effective tax rate for the Company was 9.0% and 14.0%, respectively. The Company's effective tax rate for the thirteen and twenty-six weeks ended July 2, 2016 differed from the U.S. federal statutory rate primarily as a result of the recording of valuation allowance against the pre-tax losses which was partially offset by the tax benefit resulting from the reduction of excess book basis in the Company's investment in AutoMD over its tax basis related to the sale of seven million shares of AutoMD stock in October 2014 (Refer to "Note 9 - AutoMD" of our Notes to Consolidated Financial Statements for additional details). At July 2, 2016, the Company had a deferred tax liability related to this basis difference of $690. For the thirteen and twenty-six weeks

ended July 4, 2015, the effective tax rate for the Company was 25.3% and 23.0%, respectively. The Company's effective tax rate for the thirteen and twenty-six weeks ended July 4, 2015 differed from the U.S. federal statutory rate primarily as a result of the recording of valuation allowance against the pre-tax losses that was offset by the tax benefit resulting from the reduction of excess book basis in the Company's investment in AutoMD over its tax basis.

Foreign Currency

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

Liquidity and Capital Resources

Sources of Liquidity

During the twenty-six weeks ended July 2, 2016 and July 4, 2015, we primarily funded our Base USAP operations with cash and cash equivalents generated from operations as well as through borrowing under our credit facility, and primarily funded our AutoMD operating segment using the cash investment from third-party investors. We had cash and cash equivalents of $4,913 as of July 2, 2016, representing a $624 decrease from $5,537 of cash as of January 2, 2016. The cash decrease was primarily due to the use of the AutoMD cash investment, of which funds are restricted for general operating purposes of AutoMD.

As of July 2, 2016, the Company had $4,913 of cash and cash equivalents, including $2,840 that was restricted to be used only for general operating purposes of AutoMD unless otherwise approved by AutoMD’s Board of Directors. Based on our current operating plan, we believe that our existing cash and cash equivalents, investments, cash flows from operations and available funds under our credit facility will be sufficient to finance both our Base USAP and AutoMD operating segments through at least the next twelve months (see “Debt and Available Borrowing Resources” and “Funding Requirements” below).

As of July 2, 2016, our credit facility provided for a revolving commitment of up to $30,000 subject to a borrowing base derived from certain of our receivables, inventory and property and equipment (see “Debt and Available Borrowing Resources” below).

In August 2014, we filed a shelf registration statement covering the offer and sale of up to $100,000 of common stock with the SEC. The shelf registration was declared effective by the SEC on August 20, 2014. The terms of any offering under our shelf registration statement will be determined at the time of the offering and disclosed in a prospectus supplement filed with the SEC. The shelf registration expires on August 20, 2017.

On October 8, 2014, AutoMD entered into a common stock purchase agreement to sell seven million shares of AutoMD common stock at a purchase price of $1.00 per share to third party investors reducing the Company’s ownership interest in AutoMD to 64.1%. The proceeds from the sale of AutoMD common stock will be used to fund the operating activities of AutoMD. Pursuant to the terms of the Purchase Agreement, the Company may be required to purchase 2.0 million shares of AutoMD common stock at a purchase price of $1.00 per share, with such purchase to be triggered only if as of October 8, 2016, AutoMD does not meet a required minimum number of approved auto repair shops permitted to submit a quotation on AutoMD’s website ("Registered Repair Shops"), or separately if at any time during the two years following the closing date AutoMD fails to meet specified minimum cash balances and minimum numbers of Registered Repair Shops. AutoMD is commencing with charging repair shops a subscription fee during the third quarter, and as a result, we expect the number of repair shops to decline below 5,000 as of October 8, 2016. As such, we would be required to purchase 2.0 million shares of AutoMD common stock at a purchase price of $1.00 per share under the terms of the purchase agreement entered into with AutoMD and third party investors. The Purchase Agreement also limits the use of the $7,000 in proceeds from the sale of AutoMD common stock to only general operating purposes of AutoMD. The Company cannot use or borrow any of the proceeds without the approval of AutoMD's Board of Directors.

Working Capital

As of July 2, 2016 and January 2, 2016, our working capital was $17,167 and $13,605, respectively. Our revolving loan does not require principal payments, however it is classified as current due to certain U.S. GAAP requirements (see “Debt and Available Borrowing Resources” below for further details). The historical seasonality in our business during the year can cause cash and cash equivalents, inventory and accounts payable to fluctuate, resulting in changes in our working capital.

Cash Flows

The following table summarizes the key cash flow metrics from our consolidated statements of cash flows for the twenty-six weeks ended July 2, 2016 and July 4, 2015 (in thousands):

	Twenty-Six Weeks Ended	
	July 2, 2016	July 4, 2015
Net cash provided by operating activities	$15,006	$6,486
Net cash used in investing activities	(3,012)	(3,844)
Net cash used in financing activities	(12,605)	(3,665)
Effect of exchange rate changes on cash	(13)	(22)
Net change in cash and cash equivalents	$(624)	$(1,045)

Operating Activities

Cash provided by operating activities is primarily comprised of net income (loss), adjusted for non-cash activities such as depreciation and amortization expense, amortization of intangible assets and share-based compensation expense. These non-cash adjustments represent charges reflected in net income and, therefore, to the extent that non-cash items increase or decrease our operating results, there will be no corresponding impact on our cash flows. Net income adjusted for non-cash adjustments to operating activities was $7,072 for the twenty-six weeks ended July 2, 2016 (adjusted for non-cash charges primarily related to depreciation and amortization expense of $3,704 and share-based compensation expense of $1,668), compared to net loss adjusted for non-cash adjustments to operating activities of $3,330 for the twenty-six weeks ended July 4, 2015 (adjusted for non-cash charges primarily consisting of depreciation and amortization expense of $3,756 and shared based compensation of $1,106). After excluding the effects of the non-cash charges, the primary changes in cash flows relating to operating activities resulted from changes in operating assets and liabilities.

- Accounts receivable decreased to $2,971 at July 2, 2016 from $3,236 at January 2, 2016, resulting in a decrease in operating assets and reflecting a cash inflow of $265 for the twenty-six weeks ended July 2, 2016. Accounts receivable decreased primarily due to a decrease in sales at the end of the quarter. For the twenty-six weeks ended July 4, 2015, cash inflow related to the change in accounts receivable was $686.
- Inventory decreased to $44,421 at July 2, 2016 from $51,216 at January 2, 2016, resulting in a decrease in operating assets and reflecting a cash inflow of $6,795 for the twenty-six weeks ended July 2, 2016. For the twenty-six weeks ended July 4, 2015, cash inflow related to the change in inventory was $3,142.
- Accounts payable and accrued expenses increased to $33,997 at July 2, 2016 compared to $32,790 at January 2, 2016, resulting in an increase in operating liabilities and reflecting a cash inflow of $1,308 for the twenty-six weeks ended July 2, 2016. Accounts payable and accrued expenses increased primarily due to the increase in accounts payable of $1,022. Accounts payable and accrued expenses fluctuates from period-to-period due to the amount of our revenues and the related purchases and the timing of our payments. For the twenty-six weeks ended July 4, 2015, cash outflow related to the change in accounts payable and accrued expenses was $1,258.

Investing Activities

For the twenty-six weeks ended July 2, 2016 and July 4, 2015, net cash used in investing activities was primarily the result of increases in property and equipment ($2,887 and $3,832, respectively), which are mainly related to capitalized website and software development costs.

Financing Activities

For the twenty-six weeks ended July 2, 2016, net cash used in financing activities was primarily due to net payments made on our revolving loan payable of $11,759. For the twenty-six weeks ended July 4, 2015, net cash used in financing activities was primarily due to net payments made on outstanding debt, totaling $3,036.

Debt and Available Borrowing Resources

Total debt was $10,586 as of July 2, 2016 (comprised of capital lease payable), compared to $22,448 (comprised of capital lease payable and revolving loan payable) as of January 2, 2016. The decrease was primarily due to a reduction in the amount outstanding under our line of credit from January 2, 2016 to July 2, 2016.

The Company maintains an asset-based revolving credit facility ("Credit Facility") that provides for, among other things, a revolving commitment in an aggregate principal amount of up to $30,000, which is subject to a borrowing base derived from certain receivables, inventory and property and equipment. The Credit Facility matures on April 26, 2017. At July 2, 2016, our

outstanding revolving loan balance was $0. The customary events of default under the Credit Facility (discussed below) include certain subjective acceleration clauses. Management has determined the likelihood of an acceleration is more than remote, considering the recurring losses experienced by the Company. As a result, any outstanding borrowings under the Credit Facility would be classified as a current liability.

On May 6, 2016, the Company and JPMorgan Chase Bank, N.A. (“JPMorgan”) entered into an amendment to the Credit Agreement pursuant to which a letter of credit can be issued if after giving effect to such issuance the letter of credit exposure shall not exceed $15,000, which was increased from the previously agreed upon $6,000. As of July 2, 2016, our outstanding letters of credit balance was $5,283 which we used in the ordinary course of business to satisfy certain vendor obligations. We expect our outstanding letters of credit balance to increase during the third quarter.

Loans drawn under the Credit Agreement bear interest, at the Company’s option, at a per annum rate equal to either (a) one month LIBOR plus an applicable margin of 1.50%, or (b) an “alternate prime base rate” subject to an increase or reduction by up to 0.25% based on the Company's fixed charge coverage ratio. At July 2, 2016, the Company’s LIBOR based interest rate was 2.00% (on $0 principal) and the Company’s prime based rate was 3.50% (on $0 principal). A commitment fee, based upon undrawn availability under the Credit Agreement bearing interest at a rate of 0.25% per annum, is payable monthly. Under the terms of the Credit Agreement, cash receipts are deposited into a lock-box, which are at the Company’s discretion unless the “cash dominion period” is in effect, during which cash receipts will be used to reduce amounts owing under the Credit Agreement. The cash dominion period is triggered in an event of default or if excess availability is less than the $3,600 for five business days (on a cumulative basis), and will continue until, during the preceding 60 consecutive days, no event of default existed and excess availability has been greater than $3,600 at all times (with the trigger subject to adjustment based on the Company's revolving commitment). In addition, in the event that “excess availability,” as defined under the Credit Agreement, is less than $2,400 the Company shall be required to maintain a minimum fixed charge coverage ratio of 1.0 to 1.0.

Our Credit Agreement requires us to satisfy certain financial covenants which could limit our ability to react to market conditions or satisfy extraordinary capital needs and could otherwise restrict our financing and operations. If we are unable to satisfy the financial covenants and tests at any time, we may as a result cease being able to borrow under the Credit Facility or be required to immediately repay loans under the Credit Facility, and our liquidity and capital resources and ability to operate our business could be severely impacted, which would have a material adverse effect on our financial condition and results of operations. In those events, we may need to sell additional assets or seek additional equity or additional debt financing or attempt to modify our existing Credit Agreement. There can be no assurance that we would be able to raise such additional financing or engage in such asset sales on acceptable terms, or at all, or that we would be able to modify our existing Credit Agreement.

Funding Requirements

Based on our current operating plan, we believe that our existing cash, cash equivalents, investments, cash flows from operations and available debt financing will be sufficient to finance our operational cash needs through at least the next twelve months. Our future capital requirements may, however, vary materially from those now planned or anticipated. Changes in our operating plans, lower than anticipated net sales or gross margins, increased expenses, continued or worsened economic conditions, worsening operating performance by us, or other events, including those described in “Risk Factors” included in Part II, Item 1A may force us to sell additional assets and seek additional debt or equity financing in the future. We may need to issue additional common stock under our shelf registration, discussed above. There can be no assurance that we would be able to raise such additional financing or engage in such additional asset sales on acceptable terms, or at all. If we are not able to raise adequate additional financing or proceeds from additional asset sales, we will need to defer, reduce or eliminate significant planned expenditures, restructure or significantly curtail our operations.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Contractual Obligations

The following table sets forth our contractual cash obligations and commercial commitments as of July 2, 2016:

	Payment Due By Period (in thousands)				
Contractual Obligations:	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating lease obligations (1)	$5,949	$ 833	$ 3,324	$ 1,792	$ —
Capital lease obligations (2)	18,613	639	2,630	2,434	12,910

(1) Commitments under operating leases relate primarily to our leases on our corporate offices in Carson, California, our distribution centers in Chesapeake, Virginia and our call center in the Philippines.

(2) Commitments under capital leases primarily relate to sale-leaseback of our LaSalle, Illinois facility.

Seasonality

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

Inflation

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

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, net sales, costs and expenses, as well as the disclosure of contingent assets and liabilities and other related disclosures. On an ongoing basis, we evaluate our estimates, including, but not limited to, those related to revenue recognition, uncollectible receivables, inventory reserve, 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.

There were no significant changes to our critical accounting policies during the twenty-six weeks ended July 2, 2016. We believe our critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our historical consolidated financial condition and results of operations (for further detail refer to our Annual Report on Form 10-K that we filed with the SEC on March 11, 2016):

- Revenue Recognition;
- Inventory;
- Website and Software Development Costs;
- Share-Based Compensation; and
- Income Taxes.

Recent Accounting Pronouncements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk. Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial commodity market prices and rates. We are exposed to market risk primarily in the area of changes in U.S. interest rates and conditions in the credit markets. We also have some exposure related to foreign currency fluctuations. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We do not have any derivative financial instruments as of July 2, 2016. We attempt to increase the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities and mutual funds that hold debt securities.

Interest Rate Risk. Our investment securities generally consist of mutual funds. As of July 2, 2016, our investments were comprised of $77 of investments in mutual funds that primarily hold debt securities.

As of July 2, 2016, we had a balance of $0 outstanding under a revolving loan under our credit facility. The interest rate on this loan is computed based on a LIBOR and Prime loan rate, adjusted by features specified in our loan agreement. At our debt level as of July 2, 2016, a 100 basis point increase in interest rates would not materially affect our earnings and cash flows. If, however, we are unable to meet the covenants in our loan agreement, we would be required to renegotiate the terms of credit under the loan agreement, including the interest rate. There can be no assurance that any renegotiated terms of credit would not materially impact our earnings. At July 2, 2016, our LIBOR based interest rate was 2.00% per annum (on $0 principal) and our Prime based rate was 3.50% per annum (on $0 principal). Refer to additional discussion in Item 2, under the caption “Liquidity and Capital Resources – Debt and Available Borrowing Resources” and in “Note 3 – Borrowings” of the Notes to Consolidated Financial Statements (Unaudited), included in Part I, Item 1 of this report.

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 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 gross profit and operating expenses will be lower than if currencies had remained constant. Our operating expenses in the Philippines are generally paid in Philippine Pesos, and as the exchange rate fluctuates, it adversely or favorably impacts our operating results. In light of the above, a fluctuation of 10% in the Peso/U.S. dollar exchange rate would have approximately a $530 impact on our Philippine operating expenses for the twenty-six weeks ended July 2, 2016. During fiscal year 2014, we hedged a portion of our forecasted foreign currency exposure associated with operating expenses incurred in the Philippines. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place. As of January 2, 2016 and July 2, 2016, we had no hedges in place. We are evaluating our options on how to manage this risk and considering various methods to mitigate such risk. Our Canadian website sales are denominated in Canadian dollars; however, fluctuations in exchange rates from these operations are only expected to have a nominal impact on our operating results due to the relatively small number of sales generated in Canada. We believe it is important to evaluate our operating results and growth rates before and after the effect of currency changes.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable

assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

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

Inherent Limitations on Internal Controls

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

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

The information set forth under the caption “Legal Matters” in “Note 7 – Commitments and Contingencies” of the Notes to Consolidated Financial Statements (Unaudited), included in Part I, Item 1 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” included in Part II, Item 1A of this report.

ITEM 1A. Risk Factors

Our business is subject to a number of risks which are discussed below. Other risks are presented elsewhere in this report and in our other filings with the SEC. We have marked with an asterisk (*) those risk factors that reflect substantive changes from the risk factors included in the Annual Report on Form 10-K that we filed with the SEC on March 11, 2016. 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 of the following known or unknown risks or uncertainties actually occurs with material adverse effects on us, our business, financial condition, results of operations and/or liquidity could be seriously harmed. In that event, the market price for our common stock will likely decline and you may lose all or part of your investment.

Risks Related To Our Business

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

The online market for aftermarket auto parts is less developed than the online market for many other business and consumer products, and currently represents only a small part of the overall aftermarket auto parts market. 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. Specific factors that could discourage or 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 have in the past, and will continue to revise their algorithms from time to time in an attempt to optimize their search results. For example, search engines, like Google, revise their algorithms regularly in an attempt to optimize their search results. During the past few years, we have been negatively impacted by the changes in methodology for how Google displayed or selected our different websites for customer search results, which has reduced our unique visitor count and adversely

affected our financial results. While we continue to address these ongoing challenges, during the second quarter of 2016 our unique visitor count increased by 1.0 million, or 3.4%,

to 30.2 million unique visitors compared to 29.2 million unique visitors in the second quarter of 2015 primarily due to an increase in paid traffic, partially offset by lower organic traffic. While we have been able to partially offset the decrease in our organic traffic through increases in paid search traffic, there is no guarantee we will be able to continue to increase our paid traffic at the same levels in the future. In addition, if other search engines, shopping comparison sites or similar online sources on which we rely for website traffic were to modify their general methodology for how they display or select our websites in a manner similar to the changes made by Google, or if Google continues to make changes to its search results ranking algorithms that cause those algorithms to interact with our platform in a manner that continues to reduce our unique visitors count, even fewer consumers may click through to our websites, and our financial results could be further adversely affected.

Similarly, 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, increases their fees, modifies or terminates its relationship with us, our expenses could rise, we could lose customers and traffic to our websites could decrease.

Shifting online consumer behavior for purchasers of aftermarket auto parts may shift from desktop based to mobile device based online shopping, which could impact the growth of our business and our financial results could suffer.

Mobile device based online shopping represents an increasing part of our business. Shifting consumer behavior indicates that our customers may become more inclined to shop for aftermarket auto parts through their mobile devices. Mobile customers exhibit different behaviors than our more traditional desktop based e-commerce customers. User sophistication and technological advances have increased consumer expectations around the user experience on mobile devices, including speed of response, functionality, product availability, security, and ease of use. If we are unable to continue to adapt our mobile device shopping experience from desktop based online shopping in ways that improve our customer’s mobile experience and increase the engagement of our mobile customers our sales may decline and our business and financial results may suffer.

* During the second quarter, we recorded net income, but our previous net losses may continue for the remainder of fiscal year 2016.

During second quarter of fiscal 2016 we recorded net income of $934, compared to a net loss of $775 for the second quarter of fiscal 2015. While we achieved net income of $934 during the second quarter of fiscal 2016, our net losses may continue for the remainder of fiscal year 2016, although at a lower level than in 2015. If our net losses continue, they could severely impact our liquidity, as we may not be able to provide positive cash flows from operations in order to meet our working capital requirements. We may need to borrow additional funds from our credit facility, which under certain circumstances may not be available, sell additional assets or seek additional equity or additional debt financing in the future. In such cases, there can be no assurance that we would be able to raise such additional financing or engage in such asset sales on acceptable terms, or at all. If the net losses we have experienced continue for longer than we expect because our strategies to return to positive sales growth and profitability are not successful, and if we are not able to raise adequate additional financing or proceeds from asset sales to continue to fund our ongoing operations, we will need to defer, reduce or eliminate significant planned expenditures, restructure or significantly curtail our operations, file for bankruptcy or cease operations.

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

We maintain an asset-based revolving credit facility with JPMorgan Chase Bank (the “Credit Agreement”) that provides for, among other things, a revolving commitment in an aggregate principal amount of up to $30 million subject to a borrowing base derived from certain of our receivables, inventory and property and equipment. Our Credit Agreement 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, excluding payments of preferred stock dividends which are specifically permitted under our credit facility;
- sell certain assets or merge with or into other companies;
- guarantee the debts of others;

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

Restrictions in our Credit Agreement could also prevent us from satisfying certain of our contingent obligations set forth in the documents we entered into in connection with AutoMD's sale of common stock. For example, in order for us to be able to consummate the purchase of two million shares of AutoMD common stock as required by the terms of the purchase agreement we entered into with AutoMD, which would be triggered in the event that AutoMD fails to meet specified cash balances and numbers of approved auto repair shops submitting a quotation on AutoMD's website, at the time such obligation is triggered we must have excess availability to borrow under the credit agreement of at least $2.4 million (subject to adjustment based on the Company's revolving commitment). In addition, in order for us to be able to reimburse AutoMD for legal expenses incurred by AutoMD in connection with proceedings related to AutoMD's intellectual property, which we could be required to do for a period of three years, at the time of such reimbursement we must have excess availability to borrow under the credit agreement of at least $2.4 million (subject to adjustment based on the Company's revolving commitment). In the event that restrictions in our Credit Agreement cause us to breach our contractual obligations under the documents we entered into in connection with AutoMD's sale of common stock, we could be sued for breach of contract, be liable for damages to other investors in AutoMD, and AutoMD's support from its strategic investors could be compromised, each of which could have a material adverse effect on our financial condition and results of operations.

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

Under certain circumstances, our credit facility may also require us to satisfy a financial covenant, which could limit our ability to react to market conditions or satisfy extraordinary capital needs and could otherwise impact our liquidity and capital resources, restrict our financing and have a material adverse effect on our results of operations.

Our ability to comply with the covenants and other terms of our debt obligations will depend on our future operating performance. If we fail to comply with such covenants and terms, we would be required to obtain waivers from our lenders to maintain compliance with our debt obligations. In the future, if we are unable to obtain any necessary waivers and our debt is accelerated, a material adverse effect on our financial condition and future operating performance would result.

Additionally, outstanding indebtedness has or may have important consequences, including the following:

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

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

expenditures and general operating expenses. In addition, if we need to refinance our debt, or obtain additional debt 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 this were to occur, we may need to defer, reduce or eliminate significant planned expenditures, restructure or significantly curtail our operations, file for bankruptcy or cease operations.

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 regardless of whether the product manufacturer is the party at fault. 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 or prevent us from obtaining coverage in the future. 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.

If our assets become impaired we may be required to record a significant charge to earnings.

We review our long-lived assets for impairment annually, or when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be considered are changes in circumstances indicating that the carrying value of our assets may not be recoverable include a decrease in future cash flows. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our assets is determined, resulting in an impact on our results of operations.

We are highly dependent upon key suppliers.

Our top ten suppliers represented approximately 43% of our total product purchases during the twenty-six weeks ended July 2, 2016. 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. 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.

For a number of the products that we sell, we outsource the distribution and fulfillment operation and are dependent on certain drop-ship suppliers to manage inventory, process orders and distribute those products to our customers in a timely manner. For the twenty-six weeks ended July 2, 2016, our product purchases from three drop-ship suppliers represented approximately 10% of our total product purchases. Because we outsource to suppliers 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 suppliers purchase or keep in stock. Our suppliers 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 and our sales could decline.

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. Furthermore, as part of our routine business, suppliers extend credit to us in connection with our purchase of their products. In the future, our suppliers may limit the amount of credit they are willing to extend to us in connection with our purchase of their products. If this were to occur, it could impair our ability to acquire the types and quantities of products that we desire from the applicable suppliers on acceptable terms, severely impact our liquidity and capital resources, limit our ability to operate our business and could have a material adverse effect on our financial condition and results of operations.

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

We acquire a majority of our products from manufacturers and distributors located in Taiwan and China. 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 or provide us with customary indemnification protection against third party claims similar to some of our U.S. suppliers.

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;
- natural disasters and public health emergencies;
- import shipping delays resulting from foreign or domestic labor shortages, slow downs, or stoppage; and
- the failure of local laws to provide a sufficient degree of protection against infringement of our intellectual property.

From time to time, we may also have to resort to administrative and court proceedings to enforce our legal rights with foreign suppliers. However, it may be more difficult to evaluate the level of legal protection we enjoy in Taiwan and China and the corresponding outcome of any administrative or court proceedings than in comparison to our suppliers in the United States.

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, and we may not be able to pass these costs directly to our customers. These increased shipping costs could harm our business, prospects, financial condition and results of operations by increasing our costs of doing business and reducing gross margins which could negatively affect our operating results. In particular, we utilize a variety of shipping methods for both inbound and outbound logistics. For inbound logistics, we rely on trucking and ocean carriers and any increases in fees that they charge could adversely affect our business and financial condition. For outbound logistics, we rely on ‘‘Less-than-Truckload’’ (‘‘LTL’’) and parcel freight based upon the product and quantities being shipped and customer delivery requirements. Any increases in fees or any increased use of LTL would increase our shipping costs which could negatively affect our operating results.

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

If commodity prices such as fuel, plastic and steel increase, our margins may reduce.

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

We maintain international business operations in the Philippines. This international operation includes development and maintenance of our websites, our main call center, and sales and back office support services. We are subject to a number of risks and challenges that specifically relate to our international operations. Our international operations may not be successful if we are unable to meet and overcome these challenges, which could limit the growth of our business and may have an adverse effect on our business and operating results. These risks and challenges include:

- difficulties and costs of staffing and managing foreign operations, including any impairment to our relationship with employees caused by a reduction in force;
- restrictions imposed by local labor practices and laws on our business and operations;
- exposure to different business practices and legal standards;
- unexpected changes in regulatory requirements;

- the imposition of government controls and restrictions;

- political, social and economic instability and the risk of war, terrorist activities or other international incidents;
- the failure of telecommunications and connectivity infrastructure;
- natural disasters and public health emergencies;
- potentially adverse tax consequences; and
- fluctuations in foreign currency exchange rates and relative weakness in the U.S. dollar.

If our fulfillment operations are interrupted for any significant period of time or are not sufficient to accommodate increased demand, our sales could 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 collision 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. If we do not successfully expand our fulfillment capabilities in response to increases in demand, our sales could decline.

In addition, 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. In addition, alternative arrangements may not be available, or if they are available, may increase the cost of fulfillment. 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.

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.

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

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

our network infrastructure and our ability to sell our products, harm our relationship with customers that are affected and expose us to financial liability.

In addition, any failure by us to comply with applicable privacy and information security laws and regulations could cause us to incur significant costs to protect any customers whose personal data was compromised and to restore customer confidence in us and to make changes to our information systems and administrative processes to address security issues and compliance with applicable laws and regulations. In addition, our customers could lose confidence in our ability to protect

their personal information, which could cause them to stop shopping on our sites altogether. Such events could lead to lost sales and adversely affect our results of operations. We also could be exposed to government enforcement actions and private litigation.

Moreover, we are subject to the Payment Card Industry Data Security Standard ("PCI DSS"), issued by the PCI Council. PCI DSS contains compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. We cannot be certain that all of our information technology systems are able to prevent, contain or detect any cyber-attacks, cyber terrorism, or security breaches from known malware or malware that may be developed in the future. To the extent that any disruption results in the loss, damage or misappropriation of information, we may be materially adversely affected by claims from customers, financial institutions, regulatory authorities, payment card associations and others. In addition, the cost of complying with stricter privacy and information security laws and standards could be significant to us. For example, we were recently required to transition from PCI Data Security Standard 2.0 to PCI Data Security Standard 3.1. We are in the process of conforming to the new standards which we expect to be completed within twelve months. There is no guarantee that we will be able to conform to these new standards, and if we fail to meet these standards, we could become subject to fines and other penalties and experience a significant increase in payment card transaction costs. In addition, such failure could damage our reputation, inhibit sales, and adversely affect our business.

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

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

- national auto parts retailers such as Advance Auto Parts, AutoZone, Napa Auto Parts, CarQuest, O'Reilly Automotive and Pep Boys;
- large online marketplaces such as Amazon.com and eBay;
- other online retailers of automotive products and auto repair information websites;
- local independent retailers or niche auto parts online retailers;
- wholesale aftermarket auto parts distributors such as LKQ Corporation; and
- manufacturers, brand suppliers and other distributors selling online directly to customers.

Barriers to entry are low, and current and new competitors can launch websites at a relatively low cost. Many of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing, technical, management and other resources than we do. For example, in the event that online marketplace companies such as Amazon or eBay, who have larger customer bases, greater brand recognition and significantly greater resources than we do, focus more of their resources on competing in the aftermarket auto parts market, it could have a material adverse effect on our business and results of operations. 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.

Additionally, we have experienced significant competitive pressure from certain of our suppliers who are now selling their products directly to customers. Since our suppliers have access to merchandise at very low costs, they can sell products at lower prices and maintain higher gross margins on their product sales than we can. Our financial results have been negatively impacted by direct sales from our suppliers to our current and potential customers, and our total number of orders and average order value may decline due to increased competition. Continued competition from our suppliers may also continue to negatively impact our business and results of operations, including through reduced

sales, lower operating margins, reduced profitability, loss of market share and diminished brand recognition. We are in the process of implementing several strategies to attempt to overcome the challenges created by our suppliers selling directly to our customers and potential customers, including optimizing our pricing, continuing to increase our mix of private label products and improving our websites, which may not be successful. If these strategies are not successful, our operating results and financial conditions could be materially and adversely affected.

If we fail to offer a broad selection of products at competitive prices or fail to maintain sufficient inventory to meet customer 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, including by being the first to market with new SKUs. 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. Moreover, even if we offer a broad selection of products at competitive prices, we must maintain sufficient in-stock inventory to meet consumer demand. If our product offerings fail to satisfy our customers' requirements or respond to changes in customer preferences or we otherwise fail to maintain sufficient inventory, our revenue could decline.

Challenges by OEMs to the validity of the aftermarket auto parts industry and claims of intellectual property infringement could adversely affect our business and the viability of the aftermarket auto parts industry.

OEMs have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEMs have brought such claims in federal court and with the United States International Trade Commission. We have received in the past, and we anticipate we may in the future receive, communications alleging that certain products we sell infringe the patents, copyrights, trademarks and trade names or other intellectual property rights of OEMs or other third parties. For instance, after approximately three and a half years of litigation and related costs and expenses, on April 16, 2009, we entered into a settlement agreement with Ford Motor Company and Ford Global Technologies, LLC that ended the two legal actions that were initiated by Ford against us related to claims of intellectual property infringement. The United States Patent and Trademark Office records indicate that OEMs are seeking and obtaining more design patents then they have in the past. To the extent that the OEMs are successful with intellectual property infringement claims, we could be restricted or prohibited from selling certain aftermarket products which could have an adverse effect on our business. Infringement claims could also result in increased costs of doing business arising from increased legal expenses, adverse judgments or settlements or changes to our business practices required to settle such claims or satisfy any judgments. Litigation could result in interpretations of the law that require us to change our business practices or otherwise increase our costs and harm our business. We may not maintain sufficient 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. In the past we have filed litigation to protect our intellectual property rights. The outcome of such litigation can be uncertain, and the cost of prosecuting such litigation may have an adverse impact on our earnings. We have common law trademarks, as well as pending federal trademark registrations for several marks and several registered marks. Even if we obtain approval of such pending registrations, the resulting registrations may not adequately cover our intellectual property or protect us against infringement by others. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our products and services may be made available online. We also currently own or control a number of Internet domain names, including www.usautoparts.net, www.carparts.com, www.autopartswarehouse.com, www.jcwhitney.com and www.AutoMD.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.

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 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.

As a result of our international operations, we have foreign exchange 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 gross profit and operating expenses would be higher than if currencies had remained constant. Similarly, our operating expenses in the Philippines are generally paid in Philippine Pesos, and as the exchange rate fluctuates, it could adversely impact our operating results.

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.

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 may 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.

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, due to restrictions under our credit facility or for other reasons. If we acquire 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 additional 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.

Integrating any newly acquired businesses' websites, technologies or services is likely to be costly and may require a substantial amount of resources and time to successfully complete. Our integration activities in connection with our acquisitions could cause a substantial diversion of our management's attention. If we are unable to successfully complete the integration of any acquisitions, we may not realize the anticipated synergies from such acquisitions, we may take further impairment charges and write-downs associated with such acquisitions, and our business and results of operations could suffer.

* AutoMD is an early stage company in an emerging market with an unproven business model, which makes it difficult to evaluate its current business and future prospects and may increase the risk of any investment by the Company into AutoMD.

On October 8, 2014, AutoMD entered into a Common Stock Purchase Agreement ("Purchase Agreement") to sell an aggregate of 7.0 million shares of AutoMD common stock at a purchase price of $1.00 per share to third-party investors and investors that are affiliated with two of our board members. Pursuant to the terms of the Purchase Agreement, the Company may be required to purchase 2.0 million shares of AutoMD common stock at a purchase price of $1.00 per share, with such purchase to be triggered only if as of October 8, 2016, AutoMD does not meet a required minimum number of approved auto repair shops permitted to submit a quotation on AutoMD's website ("Registered Repair Shops"), or separately if at any time during the two years following the closing date AutoMD fails to meet specified minimum cash balances and minimum numbers of Registered Repair Shops. AutoMD is currently in the process of commencing with charging a subscription fee to Registered Repair Shops, and as a result, we expect the number of Registered Repair Shops to decline below 5,000 as of October 8, 2016. As such, the Company would be contractually obligated to purchase 2.0 million shares of AutoMD common stock at a purchase price of $1.00 per share. Any such investment would be subject to a number of risks and difficulties AutoMD may encounter as an early stage company in a new and rapidly evolving online industry. These risks and difficulties include but are not limited

to the following:

- a new and unproven business model;
- adapting technology to new market opportunities and challenges;
- a limited number of product offerings and risks associated with developing and selling new product offerings;

- attracting and converting customers, many of whom may not understand the value of AutoMD's products and services; and
- effectively managing any growth in the sales force, personnel and operations of AutoMD.

AutoMD's failure to successfully address these challenges or others could significantly harm AutoMD's business, financial condition, results of operations and liquidity and could adversely impact the value of any investment by the Company into AutoMD.

Risks Related To Our Capital Stock

* Our common 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, our trading volume, activities of activist investors, or conditions or trends in the Internet or auto parts industries.

Since the completion of our initial public offering in February 2007 through July 2, 2016, 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 $0.91. 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 operations.

Our common stock may be delisted from the NASDAQ Global Market if we are unable to maintain compliance with Nasdaq's continued listing standards.

NASDAQ imposes, among other requirements, continued listing standards including minimum bid and public float requirements. The price of our common stock must trade at or above $1.00 to comply with NASDAQ's minimum bid requirement for continued listing on the NASDAQ. If our stock trades at bid prices of less than $1.00 for a period in excess of 30 consecutive business days, the NASDAQ could send a deficiency notice to us for not remaining in compliance with the minimum bid listing standards. During the second quarter of fiscal year 2016 our common stock never traded below $1.00. However, if the closing bid price of our common stock fails to meet NASDAQ's minimum closing bid price requirement, or if we otherwise fail to meet any other applicable requirements of the NASDAQ and we are unable to regain compliance, NASDAQ may make a determination to delist our common stock.

Any delisting of our common stock could adversely affect the market liquidity of our common stock and the market price of our common stock could decrease. Furthermore, if our common stock were delisted it could adversely affect our ability to obtain financing for the continuation of our operations and/or result in the loss of confidence by investors, customers, suppliers and employees.

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

As of July 2, 2016, our executive officers and directors and certain related parties and entities that are affiliated with them beneficially own approximately 40.5% of our outstanding shares of 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 control 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.

The rights, preferences and privileges of our existing preferred stock may restrict our financial and operational flexibility.

In March 2013, our Board of Directors, under the authority granted by our Certificate of Incorporation, established a series of preferred stock, our Series A Convertible Preferred, which has various rights, preferences and privileges senior to the shares of our common stock. Dividends on the Series A Convertible Preferred are payable quarterly, subject to the satisfaction of certain conditions, at a rate of $0.058 per share per annum in cash, in shares of common stock or in any combination of cash

and common stock as determined by our Board of Directors. While we may, at our election, subject to the satisfaction of certain conditions, pay any accrued but unpaid dividends on the Series A Convertible Preferred in either cash or in common stock, we may be unable to satisfy the requisite conditions for paying dividends in common stock and, under such circumstances, we will be required to pay such accrued but unpaid dividends in cash. In such circumstances, we will be required to use cash that would otherwise be used to fund our ongoing operations to pay such accrued but unpaid dividends. To the extent we do pay dividends in common stock as we have done in prior periods, the ownership percentage of our common stockholders who are not holders of the Series A Convertible Preferred will be diluted. Our Series A Convertible Preferred is initially convertible for 4,149,997 shares of common stock, and to the extent that the Series A Convertible Preferred is converted, the common stock ownership percentage of our common stockholders who are not converting holders of the Series A Convertible Preferred will be diluted.

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, including to the extent based on our ability to successfully work with different search engines to drive visitors to our websites;
- our ability to successfully sell our products through third-party online marketplaces or the effects of any price increases in those marketplaces;
- competition from companies that have longer operating histories, larger customer bases, greater brand recognition, access to merchandise at lower costs and significantly greater resources than we do, like third-party online market places and our suppliers;
- our ability to maintain and expand our supplier and distribution relationships without significant price increases or reduced service levels;
- our ability to borrow funds under our credit facility;
- 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
- macroeconomic conditions that adversely impact the general and automotive retail sales environment.

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

While management has concluded that our internal controls over financial reporting were effective as of July 2, 2016, we have in the past, and could in the future, have a significant deficiency or material weakness in internal 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 remediated, 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, regulatory investigations and other penalties.

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

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

- our Board of Directors are authorized, without prior stockholder approval, to create and issue preferred stock which could be used to implement anti-takeover devices;
- advance notice is required for director nominations or for proposals that can be acted upon at stockholder meetings;
- our Board of Directors is classified such that not all members of our board are elected at one time, which may make it more difficult for a person who acquires control of a majority of our outstanding voting stock to replace all or a majority of our directors;
- stockholder action by written consent is prohibited except with regards to an action that has been approved by the Board;
- special meetings of the stockholders are permitted to be called only by the chairman of our Board of Directors, our chief executive officer or by a majority of our Board of Directors;
- stockholders are not permitted to cumulate their votes for the election of directors; and
- stockholders are permitted to amend certain provisions of our bylaws only upon receiving at least 66 2/3% of the votes entitled to be cast by holders of all outstanding shares then entitled to vote generally in the election of directors, voting together as a single class.

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

We currently do not expect to pay any cash dividends on our common 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 collision 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.

The seasonality of our business places increased strain on our operations.

We have historically experienced higher sales of collision 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. If we do not stock or restock popular products in sufficient amounts such that we fail to meet increased customer demand, it could significantly affect our revenue and our future growth. Likewise, if we overstock products in anticipation of increased demand, we may be required to take significant inventory markdowns or write-offs and incur commitment costs, which could reduce profitability.

43

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 engine parts. If consumers were to drive less in the future, as a result of higher gas prices, increased use of ride-shares, or otherwise, our sales may decline and our business and financial results may suffer.

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

In 2015, we collected sales or other similar taxes only on the shipment of goods to the states of California, Virginia, Illinois and Ohio. The U.S. Supreme Court has ruled that vendors whose only connection with customers in a state is by common carrier or the U.S. mail are free from state-imposed duties to collect sales and use taxes in that state. However, states could seek to impose additional income tax obligations or sales tax collection obligations on out-of-state companies such as ours, which engage in or facilitate online commerce, based on their interpretation of existing laws, including the Supreme Court ruling, or specific facts relating to us. If sales tax obligations are successfully imposed upon us by a state or other jurisdiction, we could be exposed to substantial tax liabilities for past sales and penalties and fines for failure to collect sales taxes. We could also suffer decreased sales in that state or jurisdiction as the effective cost of purchasing goods from us increases for those residing in that state or jurisdiction. In addition, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's apparent position regarding sales and use taxes on Internet sales. If any of these initiatives are enacted, we could be required to collect sales and use taxes in additional states and our revenue could be adversely affected. Furthermore, the U.S. Congress has not yet extended a moratorium, which was first imposed in 1998 but has since expired, on state and local governments' ability to impose new taxes on Internet access and Internet transactions. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us as well as substantially impair the growth of e-commerce and adversely affect our revenue and profitability. Since our service is available over the Internet in multiple states, these jurisdictions may require us to qualify to do business in these states. If we fail to qualify in a jurisdiction that requires us to do so, we could face liabilities for taxes and penalties.

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

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

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

We are subject to federal and state consumer protection laws and regulations, including laws protecting the privacy of customer non-public information and regulations prohibiting unfair and deceptive trade practices, as well as laws and regulations governing businesses in general and the Internet and e-commerce and certain environmental laws. Additional laws and regulations may be adopted with respect to the Internet, the effect of which on e-commerce is

uncertain. These laws may cover issues such as user privacy, spyware and the tracking of consumer activities, marketing e-mails and communications, other advertising and promotional practices, money transfers, pricing, content and quality of products and services, taxation, electronic contracts and other communications, intellectual property rights, and information security. Furthermore, it is not clear how existing laws such as those governing issues such as property ownership, sales and other taxes, trespass, data mining and collection, and personal privacy apply to the Internet and e-commerce. 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 may not maintain sufficient 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 which warm the earth's atmosphere. These warmer weather conditions could result in a decrease in demand for auto parts in general. Moreover, proposals that would impose mandatory requirements on greenhouse gas emissions continue to be considered by policy makers in the United States. Laws enacted that directly or indirectly affect our suppliers (through an increase in the cost of production or their ability to produce satisfactory products) or our business (through an impact on our inventory availability, cost of sales, operations or demand for the products we sell) could adversely affect our business, financial condition, results of operations and cash flows. Significant increases in fuel economy requirements or new federal or state restrictions on emissions of carbon dioxide that may be imposed on vehicles and automobile fuels could adversely affect demand for vehicles, annual miles driven or the products we sell or lead to changes in automotive technology. Compliance with any new or more stringent laws or regulations, or stricter interpretations of existing laws, could require additional expenditures by us or our suppliers. Our inability to respond to changes in automotive technology could adversely impact the demand for our products and our business, financial condition, results of operations or cash flows.

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

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

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

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

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

Exhibit No.	Description
31.1	Certification of the Principal Executive Officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Principal Financial Officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

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

Date: August 8, 2016 U.S. AUTO PARTS NETWORK, INC.

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

By: /s/ Neil T. Watanabe
Neil T. Watanabe
Chief Financial Officer
(Principal Financial Accounting Officer)