U.S. Auto Parts Network, Inc.
Form 10-Q
August 10, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 2, 2011

OR

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

For the transition period from to

Commission file number: 001-33264

U.S. AUTO PARTS NETWORK, INC.

(Exact name of registrant as specified in its charter)

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

17150 South Margay Avenue

Carson, CA 90746

(Address of Principal Executive Office) (Zip Code)

(310) 735-0085

(Registrant s telephone number, including area code)

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

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

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

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

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

As of August 5, 2011, the registrant had 30,559,985 shares of common stock, $0.001 par value, outstanding.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE THIRTEEN AND TWENTY-SIX WEEKS ENDED JULY 2, 2011

TABLE OF CONTENTS

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

U.S. Auto Parts®, U.S. Auto Parts Network , PartsTrain®, Partsbin , Kool-Vue , 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.

2

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

U.S. AUTO PARTS NETWORK, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts and par value)

	July 2, 2011	January 1, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,249	$ 17,595
Short-term investments	1,112	1,062
Accounts receivable, net of allowances of $200 and $372, respectively	8,839	6,849
Inventory	45,804	48,100
Deferred income taxes	360	359
Other current assets	4,448	5,646
Total current assets	76,812	79,611
Property and equipment, net	34,346	33,140
Intangible assets, net	15,781	18,718
Goodwill	17,344	17,137
Investments	3,766	4,141
Other non-current assets	1,073	790
Total assets	$ 149,122	$ 153,537
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 33,014	$ 31,660
Accrued expenses	13,741	15,487
Current portion of long-term debt	6,250	6,125
Current portion of capital leases payable	149	132
Other current liabilities	5,181	5,522
Total current liabilities	58,335	58,926
Long-term debt, net of current portion	14,750	17,875
Capital leases payable, net of current portion	94	185
Deferred income taxes	3,267	3,046
Other non-current liabilities	963	701
Total liabilities	77,409	80,733
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.001 par value; 100,000,000 shares authorized at July 2, 2011 and January 1, 2011; 30,559,985 and 30,429,376 shares issued and outstanding at July 2, 2011 and January 1, 2011, respectively	31	30
Additional paid-in capital	155,620	153,962
Accumulated other comprehensive income	309	249
Accumulated deficit	(84,247)	(81,437)

Total stockholders equity	71,713	72,804
Total liabilities and stockholders equity	$ 149,122	$ 153,537

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share amounts)

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Net sales	$ 84,268	$ 53,188	$ 171,246	$ 109,479
Cost of sales [(1)]	55,854	34,791	112,416	71,275
Gross profit	28,414	18,397	58,830	38,204
Operating expenses:				
Marketing [(2)]	14,366	7,138	27,951	14,351
General and administrative [(2)]	8,407	6,395	16,643	12,132
Fulfillment [(2)]	4,592	2,924	9,599	6,167
Technology [(2)]	1,917	1,158	3,855	2,176
Amortization of intangibles	1,363	124	2,990	245
Total operating expenses	30,645	17,739	61,038	35,071
(Loss) income from operations	(2,231)	658	(2,208)	3,133
Other income (expense):				
Other income (expense)	47	(5)	78	(4)
Interest (expense) income	(185)	34	(467)	55
Total other (expense) income, net	(138)	29	(389)	51
(Loss) income before income taxes	(2,369)	687	(2,597)	3,184
Income tax provision	195	225	213	1,175
Net (loss) income	$ (2,564)	$ 462	$ (2,810)	$ 2,009
Basic net (loss) income per share	$ (0.08)	$ 0.02	$ (0.09)	$ 0.07
Diluted net (loss) income per share	$ (0.08)	$ 0.01	$ (0.09)	$ 0.06
Shares used in computation of basic net (loss) income per share	30,543,037	30,314,478	30,496,558	30,158,797
Shares used in computation of diluted net (loss) income per share	30,543,037	31,994,447	30,496,558	31,723,316

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

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

Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended	Twenty-Six Weeks Ended

			July 2, 2011	July 3, 2010
Marketing	$ 88	$ 72	$ 248	$ 192
General and administrative	399	452	775	1,000
Fulfillment	91	64	176	189
Technology	65	24	125	91
Total share-based compensation expense	$ 643	$ 612	$ 1,324	$ 1,472

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Operating activities		
Net (loss) income	$ (2,810)	$ 2,009
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	6,075	3,934
Amortization of intangibles	2,990	245
Share-based compensation	1,324	1,472
Deferred income taxes	219	790
Amortization of deferred financing costs	61	
Excess tax benefits from share-based payment arrangements		(237)
Changes in operating assets and liabilities:		
Accounts receivable	(1,990)	802
Inventory	2,296	(7,926)
Prepaid expense and other current assets	(187)	(865)
Other noncurrent assets		(81)
Accounts payable and accrued expenses	(477)	7,639
Other current liabilities	(338)	1,218
Other noncurrent liabilities	258	317
Net cash provided by operating activities	7,421	9,317
Investing activities		
Additions to property and equipment	(7,221)	(6,293)
Purchases of intangibles	(48)	(1,001)
Changes in restricted cash	319	
Proceeds from sale of marketable securities	400	4,236
Purchases of marketable securities	(13)	(17,984)
Purchases of company-owned life insurance	(281)	(250)
Proceeds from purchase price adjustment	787	
Net cash used in investing activities	(6,057)	(21,292)
Financing activities		
Payments made on long-term debt	(3,000)	
Changes in book overdraft	152	
Payments of short-term financing	(74)	
Payments of debt financing costs	(53)	
Excess tax benefits from share-based payment arrangements		237
Proceeds from exercise of stock options	255	658
Net cash (used in) provided by financing activities	(2,720)	895
Effect of exchange rate changes on cash	10	26
Net change in cash and cash equivalents	(1,346)	(11,054)
Cash and cash equivalents, beginning of period	17,595	26,251
Cash and cash equivalents, end of period	$ 16,249	$ 15,197

Supplemental disclosure of non-cash investing and financing activities:				
Accrued asset purchases	$	1,572	$	571
Property acquired under capital lease		32		
Unrealized gain on investments		27		66
Supplemental disclosure of cash flow information:				
Cash paid during the period for income taxes	$	9	$	87
Cash paid during the period for interest		611		

See accompanying notes to unaudited condensed consolidated financial statements.

6

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

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

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

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

Basis of Presentation

The unaudited condensed 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 unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of July 2, 2011 and January 1, 2011, and the consolidated results of operations for the thirteen and twenty-six weeks ended July 2, 2011 and July 3, 2010, and cash flows for the twenty-six weeks ended July 2, 2011 and July 3, 2010. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. The Company s results of operations for the thirteen and twenty-six weeks ended July 2, 2011 are not necessarily indicative of those to be expected for the entire year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended January 1, 2011 (fiscal 2010), which was filed with the SEC on March 17, 2011.

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, but are not limited to, the valuation of investments, valuation of inventory, valuation of deferred tax assets and liabilities, and valuation of intangible assets, including goodwill. Actual results could differ from these estimates.

Segment Data

The Company manages its operations on a consolidated basis for purposes of assessing performance and making operating decisions. Accordingly, the Company operates in one reportable segment and reporting revenues by product line or geographic location is impracticable.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29), an update to Accounting Standards Codification (ASC) Topic 805, *Business Combinations* (ASC 805). The amendments in ASU 2010-29 specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments in ASU 2010-29 also expand the supplemental pro forma disclosures under ASC 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The Company will apply the provisions of ASU 2010-29 to future acquisitions which occur after January 2, 2011. The Company believes that the adoption will not have a material effect on the Company s consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04), an update to ASC Topic 820, *Fair Value Measurement* (ASC 820). The amendments in ASU 2011-04 are the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework and provide converged guidance on how to measure fair value and on what disclosures to provide about fair value measurements. While ASU 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands ASC 820 s existing disclosure requirements for fair value measurements and makes other amendments. Many of these amendments were made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards (IFRSs). However, some could change how the fair value measurement guidance in ASC 820 is applied. For public entities, amendments are effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the provisions of ASU 2011-04 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. The Company believes that this adoption will not have a material effect on the Company s consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), an update to ASC Topic 220, *Comprehensive Income* (ASC 220). The amendments in ASU 2011-05 revise the manner in which entities present comprehensive income in their financial statements by removing the presentation options in ASC 220 and requiring entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The amendments in ASU 2011-5 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company will adopt the provisions of ASU 2011-05 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. This adoption will have an impact on the presentation of other comprehensive income on the Company s consolidated financial statements.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2 Investments

As of July 2, 2011, the Company held the following securities and investments, recorded at fair value (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Auction rate preferred securities in municipal and state agencies (1)	$ 3,825	$	$ (59)	$ 3,766
Mutual funds and money market funds (2)	1,118		(6)	1,112
Total	$ 4,943	$	$ (65)	$ 4,878

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

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

(1) Auction rate preferred securities (ARPS) issued by municipal and state agencies have a maturity of 15 to 30 years and are classified as long-term investments available-for-sale. As of July 2, 2011 and January 1, 2011, all of these securities were held in three tax-exempt municipal bonds managed under closed-end funds and had been in a continuous loss position for more than twelve months.

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

Proceeds from the sale of available-for-sale securities are disclosed separately in the accompanying unaudited condensed consolidated statements of cash flows. For the thirteen and twenty-six weeks ended July 2, 2011 and July 3, 2010, there were no recognized gross realized gain and losses.

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

Note 3 Fair Value Measurements

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

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

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

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

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

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial Assets Valued on a Recurring Basis

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

	As of July 2, 2011			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash and cash equivalents (1)	$ 16,249	$ 16,249	$	$
Short-term investments (2)	1,112	1,112		
Non-current investments available-for-sale (3)	3,766			3,766
	$ 21,127	$ 17,361	$	$ 3,766

	As of January 1, 2011			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash and cash equivalents (1)	$ 17,595	$ 17,595	$	$
Short-term investments (2)	1,062	1,062		
Non-current investments available-for-sale (3)	4,141			4,141
	$ 22,798	$ 18,657	$	$ 4,141

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

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

(3) As of July 2, 2011, the Company had invested $3,825 (par value in thousands) in ARPS, which are classified as available-for-sale securities and reflected at $3,766 (fair value in thousands), which includes an unrealized loss of $59 (in thousands). As of January 1, 2011, the Company had invested $ 4,225 (par value in thousands) in ARPS, which were classified as available-for-sale securities and reflected at $ 4,141 (fair value in thousands), which included an unrealized loss of $84 (in thousands). The Company has included its investments related to ARPS in the Level 3 category.

Before utilizing Level 3 inputs in fair value measurement, the Company considered significant Level 2 observable inputs of similar assets in active and inactive markets. The Company s broker dealer received estimated market values from an independent pricing service as of the balance sheet date and the anticipated future market for such investments. These investments consist solely of collateralized debt obligations supported by municipal and state agencies; do not include mortgage-backed securities or student loans; have redemption features that call for redemption at 100% of par value; and have a current credit rating of A or AAA. For the period between June 30, 2008 through July 2, 2011, the Company received partial redemptions at par on these investments totaling $3.9 million. The fact that there is not an active market to liquidate these investments was considered in classifying them as Level 3. Due to the uncertainty with regard to the short-term liquidity of these securities, the Company determined that it could not rely on par value to represent fair value. Therefore, the Company estimated the fair values of these securities utilizing a discounted cash flow valuation model as of July 2, 2011 and January 1, 2011. This analysis considered the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation the security will have a successful auction or market liquidity. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company.

As a result of the temporary declines in fair value for the Company s ARPS, which the Company generally attributes to liquidity issues rather than credit issues, the Company recorded an unrealized loss of $59 and $84 (in thousands) to accumulated other comprehensive income as of July 2, 2011 and January 1, 2011, respectively. Due to the Company s belief that the market for these collateralized instruments may take in excess of twelve months to fully recover, the Company has classified these investments as noncurrent and has included them in investments on the unaudited condensed consolidated balance sheets at July 2, 2011 and January 1, 2011. As of July 2, 2011, the Company continued to earn interest on all of its ARPS instruments. Any future fluctuation in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income. If the Company determined that any decrease in the value of the instruments was other-than-temporary, it would record a charge to earnings as appropriate. The Company is not certain how long it may be required to hold each security. However, given the Company s current cash position, liquid cash equivalents and expected cash provided by operations, it believes it has the ability to hold, and intends to continue to hold the ARPS as long-term investments until the market for such securities stabilizes.

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Long-Term Investments
Balance as of January 1, 2011	$ 4,141
Redemption	(400)
Unrealized gains included in other comprehensive income	25
Balance as of July 2, 2011	$ 3,766

	Long-Term Investments
Balance as of January 2, 2010	$ 4,264
Redemption	(125)
Unrealized gains included in other comprehensive income	2
Balance as of January 1, 2011	$ 4,141

Non-Financial Assets Valued on a Non-Recurring Basis

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

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

Note 4 Inventory

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

Note 5 Business Combination

On August 12, 2010, the Company completed the purchase (the Acquisition) of all of the issued and outstanding shares of Automotive Specialty Accessories and Parts (WAG), a leader in the automobile aftermarket performance parts and accessories market. Assets acquired include intangible assets consisting of customer relationships, technology, and trade names, tangible assets such as furniture and fixtures, machinery and equipment, and a 350,000 square foot distribution center in LaSalle, Illinois with a headquarter office located in Chicago, Illinois. The final purchase price of WAG was $26.7 million in cash, including certain adjustments as set forth in that certain Stock Purchase Agreement executed August 2, 2010 (the Purchase Agreement) among Go Fido, Inc., WAG, 2000 Riverside Capital Appreciation Fund, L.P. and the other stockholders of WAG. The Acquisition provided the Company with product line expansion into all terrain vehicles, recreational vehicles and motorcycles, as well as deep product knowledge into niche segments like Jeep, Volkswagen and truck enthusiasts. This expansion in its product line has increased its customer reach in the do-it-yourself automobile and off-road accessories market. In addition, WAG s state-of-the-art facility located in Illinois, which was custom built for business-to-consumer distribution of auto parts, allowed the Company to complete a three-distribution center network. The Company believes that the combination of WAG s established brands and focus on the customer experience, coupled with the Company s capacity to compete online, creates opportunity for growth. These expected synergies from the Acquisition contributed to the goodwill associated with the Acquisition of $7.6 million. See the purchase price allocation table below for further details.

The Acquisition has been accounted for under the purchase method of accounting in accordance with ASC 805. Accordingly, the assets and liabilities of WAG have been recorded as of the acquisition date at their respective fair values, and combined with the Company s assets and liabilities. The determination of estimated fair value requires management to make significant estimates and assumptions. The results of operations of WAG and the estimated fair market values of the acquired assets and liabilities have been included in the consolidated financial statements from the date of the Acquisition.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes our allocation of the purchase price for the Acquisition to the estimated fair values of the assets acquired and liabilities assumed at the date of the Acquisition (in thousands):

Purchase price paid in cash (1)	$ 27,500
Purchase price adjustment (2)	(787)
Final purchase price	**$ 26,713**
Purchase price allocation is presented below:	
Assets:	
Accounts receivable	2,642
Inventory	12,366
Deferred income taxes	120
Property and equipment	16,430
Intangible assets	17,378
Other assets	2,287
Total assets	$ 51,223
Liabilities:	
Accounts payable	$ (23,542)
Accrued expenses	(4,534)
Deferred income taxes	(2,734)
Other liabilities	(1,272)
Total liabilities	$ (32,082)
Goodwill (3)	$ 7,572
Final purchase price	**$ 26,713**

(1) Represents the purchase price paid in cash at the closing of the Acquisition of $27.5 million.

(2) The purchase price adjustment of $787 (in thousands) represents the settlement amount that shareholders of WAG paid to USAP for the negative working capital amount of WAG on the date of the Acquisition. The net working capital of WAG on the date of the Acquisition was determined in accordance with the definitions and procedures set forth in the Purchase Agreement.

(3) The goodwill resulting from the Acquisition is non-deductible for tax purposes.

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

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

12

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

WAG s financial results have been included in our consolidated statement of operations since the acquisition date of August 12, 2010. Therefore, pro forma information for the thirteen and twenty-six weeks ended July 2, 2011 has not been presented since the results of operations of WAG have been included in our actual consolidated results of operations for the entire period. The following pro forma financial information presents the results as if the Acquisition had occurred on January 3, 2010 (in thousands, except share and per share amounts):

	Thirteen Weeks Ended July 3, 2010	Twenty-six Weeks Ended July 3, 2010
Net sales	$ 89,524	$ 174,641
Net loss	(8,142)	(20,912)
Basic net loss per share	(0.27)	(0.69)
Diluted net loss per share	(0.27)	(0.69)
Weighted average shares used in computing basic net loss per common share	30,314,478	30,158,797
Weighted average shares used in computing diluted net loss per common share	30,314,478	30,158,797

Related to the Acquisition, the Company has incurred acquisition and integration related costs of $5.9 million, which have been recorded in general and administrative expenses.

Note 6 Goodwill and Intangibles

The following table summarizes the change in our goodwill during the twenty-six weeks ended July 2, 2011 as follows (in thousands):

Balance at January 1, 2011	$ 17,137
Change in goodwill	207
Balance at July 2, 2011	$ 17,344

During the thirteen weeks ended July 2, 2011, the Company recorded goodwill adjustments of $207 (in thousands) related to the settlement amount that the Company received from the shareholders of WAG for the negative working capital amount of WAG on the date of the Acquisition. During the twenty-six weeks ended July 2, 2011, no additional goodwill was recorded.

The Company evaluates goodwill for impairment on an annual basis or more frequently if events or circumstances occur that would indicate a reduction in fair value. As of October 31, 2010, the Company performed its annual impairment test and the excess of fair value estimates over carrying value for our reporting unit was approximately $187 million. Based on its analysis, there would have to be a 65% decrease in the fair value of the reporting unit to fail step 1. During the twenty-six weeks ended July, 2, 2011, there was no change to the Company s reporting unit and no events or circumstances occurred that would indicate a reduction in fair value. The accumulated impairment loss on goodwill was $4.4 million as of July 2, 2011 and January 1, 2011.

Intangibles subject to amortization are expensed on a straight-line basis. Amortization expense relating to intangibles totaled $1,363 and $2,990 (in thousands) for the thirteen and twenty-six weeks ended July 2, 2011, respectively. Amortization expense relating to intangibles totaled $124 and $245 (in thousands) for the thirteen and twenty-six weeks ended July 3, 2010, respectively. During the thirteen and twenty-six weeks ended July 2, 2011, the Company purchased certain domain and trade names for a purchase price of $22 (in thousands) and $48 (in thousands), respectively. All of these assets were allocated to intangible assets not subject to amortization.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

		July 2, 2011			January 1, 2011		
	Useful Life	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount
Intangible assets subject to amortization:							
Websites	5 years	$ 2,035	$ (798)	$ 1,237	$ 2,035	$ (594)	$ 1,441
Internet platform intellectual property (1)	10 months	4,300	(4,300)		4,300	(1,984)	2,316
Product design intellectual property (1)	9 years	2,750	(265)	2,485	2,750	(116)	2,634
Customer relationships (1)	4 years	2,050	(455)	1,595	2,050	(197)	1,853
Assembled workforce	7 years	483	(228)	255	478	(182)	296
Favorable lease (1)	2.5 years	78	(31)	47	78	(14)	64
Sub-Total		11,696	(6,077)	5,619	11,691	(3,087)	8,604
Intangible assets not subject to amortization:							
Domain and trade names (2)	Indefinite life	10,162		10,162	10,114		10,114
Total		$ 21,858	$ (6,077)	$ 15,781	$ 21,805	$ (3,087)	$ 18,718

(1) Includes the intangible assets acquired in connection with the Acquisition.
(2) Includes domain names assigned a value of $8.2 million purchased in connection with the Acquisition.

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

2011	$ 675
2012	1,344
2013	1,281
2014	881
2015	303
Thereafter	1,135
Total	$ 5,619

Note 7 Borrowings

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

The Loan Agreement requires the Company to comply with a number of restrictive covenants, including financial covenants related to maximum funded debt to consolidated EBITDA, liquidity, and consolidated fixed charge coverage ratios; negative pledge requirements; requirements

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

to deliver quarterly and annual consolidated financial statements; requirements to maintain adequate insurances; prohibitions on changes in the business and disposition of the Company s assets; and other customary covenants. The Loan Agreement also requires the Company to obtain a prior written consent from the Bank when the Company determines to pay any dividends on or make any distribution related to its common stock. The Loan Agreement includes usual and customary events of default and remedies for facilities of this nature. In February 2011, the Company and the Bank entered into Amendment No. 1 to Loan and Security Agreement and Limited Waiver (Amendment). The Amendment waived the Company s lack of compliance with the consolidated fixed charge coverage ratio covenant in the Loan Agreement as of January 1, 2011. The Amendment also amended the definitions of Baseline Liquidity and Consolidated EBITDA to more readily accommodate the Company s integration of the WAG acquisition. For the thirteen and twenty-six weeks ended July 2, 2011, the Company was in compliance with all covenants under the credit facility.

The Loan Agreement, as amended by the Amendment, contains the following financial covenants:

Maximum funded debt to consolidated EBITDA. A ratio of aggregate credit extensions outstanding to trailing 12 month consolidated EBITDA of not greater than the following:

2.25:1.00 from effective date through quarter ending September 30, 2010

2.00:1.00 for quarters ending December 31, 2010 through June 30, 2011

1.50:1.00 for quarters ending September 30, 2011 through June 30, 2012

1.00:1.00 for each quarter ending thereafter

Consolidated fixed charge coverage ratio for the period set forth below of not less than the ratio set forth below:

1.10:1.00 for two quarters ending December 31, 2010

1.25:1.00 for three quarters ending March 31, 2011

1.25:1.00 for four quarters ending June 30, 2011, September 30, 2011 and December 31, 2011

1.50:1.00 for each quarter ending thereafter

Liquidity as follows:

Unrestricted cash and cash equivalents (less outstanding advances) should be greater than $7,500,000 plus integration capital expenditures added back.

The Company s financial covenant ratios under the Loan Agreement as of July 2, 2011 were 1.16:1.00 for maximum funded debt to consolidated EBITDA and 1.58:1.00 for consolidated fixed charge coverage. As of July 2, 2011, the Company s required liquidity under the Loan Agreement was $11,400,000, and adding back the integration capital expenditures, the Company s liquidity was $17,362,000.

The Company expects to be in compliance with the financial covenants in the Loan Agreement through the term of the Loan Agreement. However, it is possible that a default under certain financial covenants may occur in the future, should the Company s forecasted EBITDA levels not be achieved. If the Company defaults on any of the covenants under the Loan Agreement and is unable to obtain waivers from the Bank, the Bank will be able to exercise their rights and remedies under the Loan Agreement, including a call provision on outstanding debt, which would have a material adverse effect on the Company s business and financial condition.

At July 2, 2011, the LIBOR rate and the margin were 1.25% and 2.50% per annum, respectively. The Company had no borrowings on the revolving line of credit at July 2, 2011. The remaining term loan balance was $21 million as of July 2, 2011 and is to be repaid according to the following schedule (in thousands):

Payments Due by Period				
Total	**2011**	**2012**	**2013**	**2014**
$21,000	$3,125	$6,250	$6,875	$4,750

Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of our long-term debt under the facility approximated its carrying amount as of July 2, 2011.

Note 8 Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC Topic 718, *Stock Compensation* (ASC 718). All stock options issued to employees are recognized as share-based compensation expense in the financial statements based on their respective grant date fair values, and are recognized within the statements of operations as general and administrative, marketing, fulfillment or technology expense, based on employee departmental classifications.

Under these guidelines, the fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. The Company currently uses the Black-Scholes option pricing model to estimate the fair value of share-based payment awards. The determination of the fair value of share-based payment awards utilizing the Black-Scholes option pricing model is affected by the Company s stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. As of July 2, 2011, the Company did not have an adequate history of market prices of its common stock as the Company recently became a public company, and as such, the Company estimates volatility using historical volatilities of similar public entities. The expected life of the awards is based on a simplified method which defines the life as the average of the contractual term of the options and the weighted average vesting period for all open tranches. Due to the limited period of time our equity shares have been publicly traded, we do not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of awards. The dividend yield assumption is based on the Company s expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company considers many factors when estimating expected forfeitures, including employee class, economic environment, and historical experience. Share-based compensation expense recognized in our financial statements is based on awards that are ultimately expected to vest. If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested options, we may be required to accelerate, increase or cancel any remaining unrecognized share-based compensation expense.

The Company also accounts for equity instruments issued in exchange for board services rendered by non-employee directors in accordance with the provisions of ASC 718.

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

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under the Company s 2007 Omnibus Incentive Plan, the Company granted stock options to purchase 120,000 shares of common stock during the thirteen weeks ended July 2, 2011 at a weighted-average grant date fair value of $7.43. The Company granted stock options to purchase 660,000 shares of common stock during the twenty-six weeks ended July 2, 2011 at a weighted-average grant date fair value of $7.75. The Company had $3.4 million of unrecognized share-based compensation expense related to stock options outstanding as of July 2, 2011, which expense is expected to be recognized over a weighted-average period of 2.35 years. During the thirteen weeks ended July 2, 2011, options to purchase 40,991 shares were exercised and the total intrinsic value of the exercised options was $0.2 million. During the twenty-six weeks ended July 2, 2011, options to purchase 70,991 shares were exercised and the total intrinsic value of the exercised options was $0.3 million. The intrinsic value of stock options at the date of the exercise is the difference between the fair value of the stock at the date of exercise and the exercise price. At July 2, 2011, 2,585,395 shares of common stock were available for future grants under this plan.

Under the Company s 2007 New Employee Incentive Plan, there were no stock options granted during the twenty-six weeks ended July 2, 2011. The Company had $0.1 million of unrecognized share-based compensation expense related to stock options outstanding under this plan as of July 2, 2011, which expense is expected to be recognized over a weighted-average period of 1.26 years. During the twenty-six weeks ended July 2, 2011, there were no options exercised under this plan. At July 2, 2011, 750,000 shares of common stock were available for future grants under this plan.

Under the Company s 2006 Equity Incentive Plan, there were no stock options granted during the twenty-six weeks ended July 2, 2011. The Company had no unrecognized share-based compensation expense related to stock options outstanding under this plan as of July 2, 2011. During the twenty-six weeks ended July 2, 2011, there were no options exercised under this plan. As of July 2, 2011, there were 2,758,095 shares of common stock available for future grants under this plan.

On May 5, 2009, the Company issued warrants to purchase up to 30,000 shares of common stock, which warrants terminate seven years after their grant date. The warrants were issued in connection with the financial advisory services provided by a consultant to the Company. The warrants vest in thirty-six equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing May 5, 2009. The re-measured fair value of these warrants was $5.87 per share at July 2, 2011. On April 27, 2010, the Company issued additional warrants to purchase up to 20,000 shares of common stock to the same holder in connection with the financial advisory services provided to the Company. The warrants vest in twenty-four equal monthly increments of 833 shares each on the last calendar day of each calendar month commencing April 27, 2010. The re-measured fair value of these warrants was $3.18 per share at July 2, 2011. The Company determined the fair value of the warrants using the Black-Scholes option pricing model based on the estimated fair value of the underlying common stock. There were no warrants exercised during the twenty-six weeks ended July 2, 2011.

Note 9 Income Taxes

For the thirteen weeks ended July 2, 2011 and July 3, 2010, the effective tax rate for the Company was (8.2)% and 32.8%, respectively. For the twenty-six weeks ended July 2, 2011 and July 3, 2010, the effective tax rate for the Company was (8.2)% and 36.9%, respectively. The Company s effective tax rate for the thirteen and twenty-six weeks ended July 2, 2011 differed from the U.S. federal statutory rate primarily due to an increase in valuation allowance against pre-tax operating losses and recording of provision for increasing long-term deferred tax liabilities associated with indefinite-lived intangibles which would not be offset with the operating losses. The increase in the valuation allowance was due to uncertainty regarding the future realization of the deferred tax assets established by the entity

As of July 2, 2011, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. The Company s policy is to record accrued interest and penalties related to unrecognized tax benefits as income tax expense.

The Company is subject to U.S. federal income tax as well as income tax of foreign and state tax jurisdictions. The Company s foreign and state income tax returns are open to audit under the statute of limitations for the tax years 2006 through 2010. The Company does not anticipate a significant change to the total amount of unrecognized tax benefits within the next twelve months.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10 Comprehensive (Loss) Income

The Company reports comprehensive (loss) income in accordance with ASC Topic 220, *Comprehensive Income*, which defines comprehensive (loss) income as net (loss) income affected by non-stockholder changes in equity. Comprehensive (loss) income for the thirteen and twenty-six weeks ended July 2, 2011 and July 3, 2010 was as follows (in thousands):

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Net (loss) income	$ (2,564)	$ 462	$ (2,810)	$ 2,009
Foreign currency translation adjustments	14	(75)	33	13
Unrealized gain (loss) in investments	16	75	27	66
Comprehensive (loss) income	$ (2,534)	$ 462	$ (2,750)	$ 2,088

Note 11 Net (Loss) Income Per Share

Basic net (loss) income per share is computed by dividing net (loss) income by the weighted average number of common shares outstanding for the period. Diluted earnings per share is applicable only in periods of net income and is computed by dividing net income by the weighted average number of common shares outstanding for the period and potentially dilutive common stock equivalents outstanding for the period. Periods of net loss require the diluted computation to be the same as the basic computation. Due to the loss in the thirteen and twenty-six weeks ended July 2, 2011, 1,566,880 and 1,663,170 shares, respectively, have been excluded from the computation of diluted net (loss) income per share.

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

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Net (Loss) Income Per Share				
Numerator:				
Net (loss) income	$ (2,564)	$ 462	$ (2,810)	$ 2,009
Denominator:				
Weighted-average common shares outstanding (basic)	30,543,037	30,314,478	30,496,558	30,158,797
Common equivalent shares from common stock options and warrants		1,679,969		1,564,519
Weighted-average common shares outstanding (diluted)	30,543,037	31,994,447	30,496,558	31,723,316
Basic net (loss) income per share	$ (0.08)	$ 0.02	$ (0.09)	$ 0.07
Diluted net (loss) income per share	$ (0.08)	$ 0.01	$ (0.09)	$ 0.06

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

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Warrants to purchase common stock	20,000	8,132	20,000	4,066
Options to purchase common stock	2,246,048	1,409,478	1,801,597	1,369,333
Total	2,266,048	1,417,610	1,821,597	1,373,399

Note 12 Deferred Compensation Plan

In January 2010, the Company adopted the U.S. Auto Parts Network, Inc. Management Deferred Compensation Plan (the Deferred Compensation Plan), for the purpose of providing highly compensated employees a program to meet their financial planning needs. The Deferred Compensation Plan provides participants with the opportunity to defer up to 90% of their base salary and up to 100% of their annual earned bonus, all of which, together with the associated investment returns, are 100% vested from the outset. The Deferred Compensation Plan, which is designed to be exempt from most provisions of the Employee Retirement Security Act of 1974, is informally funded by the Company through the purchase of Company-owned life insurance policies with the Company as the owner and beneficiary, in order to preserve the tax-deferred savings

17

U.S. AUTO PARTS NETWORK, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

advantages of a non-qualified plan. The Deferred Compensation Plan assets are the cash surrender value of the Company-owned life insurance policies and not associated with the deferred compensation liability. The deferred compensation liabilities (consisting of employer contributions, employee deferrals and associated earnings and losses) are general unsecured obligations of USAP. Liabilities under the Deferred Compensation Plan are recorded at amounts due to participants, based on the fair value of participants selected investments. The Company may at its discretion contribute certain amounts to eligible employee accounts. In January 2010, the Company began to contribute 50% of the first 2% of participants eligible contributions into their Deferred Compensation Plan accounts. In September 2010, the Company established and transferred its ownership to a rabbi trust to hold the Company-owned life insurance policies. As of July 2, 2011, the assets and associated liabilities of the Deferred Compensation Plan were $550,000 and $358,000, respectively, and are included in other non-current assets and non-current liabilities, respectively, in our consolidated balance sheets. The associated liabilities mainly include the employee contributions of $299,000 and the Company contributions of $59,000 made as of July 2, 2011. Included in other income, the Company recorded a loss of $3,000 and a gain of $9,000 for the change in the cash surrender value of the Company-owned life insurance policies during the thirteen and twenty-six weeks ended July 2, 2011, respectively.

Note 13 Contingencies

Parts Geek Litigation

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

California Air Resources Board Inquiry

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

Asbestos

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

Table of Contents

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

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC, including our Annual Report on Form 10-K for the year ended January 1, 2011 and subsequent reports on Forms 10-Q and 8-K, which discuss our business in greater detail. The section entitled Risk Factors set forth below, and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition in the future. You should carefully consider those risks, in addition to the other information in this report and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.

Overview

We are one of the largest online providers of aftermarket auto parts, including body parts, engine parts, and performance parts and accessories. Our user-friendly websites provide customers with a broad selection of Stock Keeping Units (SKUs), with detailed product descriptions and photographs. Our proprietary product database maps our SKUs to product applications based on vehicle makes, models and years. We principally sell our products to individual consumers through our network of websites and online marketplaces. Our flagship websites are located at *www.autopartswarehouse.com, www.partstrain.com*, *www.jcwhitney.com, www.stylintrucks.com, www.AutoMD.com* and our corporate website is located at *www.usautoparts.net*. We believe our strategy of disintermediating the traditional auto parts supply chain and selling products directly to customers over the Internet allows us to more efficiently deliver products to our customers while generating higher margins.

Our History. We were formed in Delaware in 1995 as a distributor of aftermarket auto parts and launched our first website in 2000. We rapidly expanded our online operations, increasing the number of SKUs sold through our e-commerce network, adding additional websites, , improving our internet marketing proficiency and commencing sales in online marketplaces. Additionally, in August 2010, through our acquisition of WAG, we expanded our product-lines and increased our customer reach in the do-it-yourself automobile and off-road accessories market. As a result, our business has grown since 2000, generating net sales of $262 million for fiscal 2010.

International Operations. In April 2007, we entered into a purchase agreement to bring in-house certain sales and customer service employees based in the Philippines, who were providing support to us through our outsourced call center provider, Access Worldwide. As of the closing of this transaction, approximately 171 of the Access Worldwide employees had agreed to transition over to direct employment by our Philippines subsidiary. The purchase price for the right to acquire this assembled workforce was approximately $1.7 million. We had 1,014 employees in our Philippines operations as of July 2, 2011. In addition to our Philippines operations, we own a Canadian subsidiary to facilitate sales of our products in Canada which currently has no employees. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a cost-effective manner, and we expect to continue to add headcount and infrastructure to our offshore operations.

Acquisitions. From time to time, we may acquire certain businesses, websites, domain names, or other assets. In the third quarter of fiscal 2009, we completed the acquisition of the assets of a small website and the related domain names which further expanded and enhanced our product offering and our ability to reach more customers. In the first quarter of fiscal 2010, we completed two additional website and domain name asset acquisitions, which we expect will increase our net sales and internet traffic. In August 2010, Go Fido, Inc., a wholly-owned subsidiary of ours, completed the purchase of all of the outstanding capital stock of WAG. WAG s state-of-the-art facility in Illinois expands our distribution network and the merchandise WAG offers extends our go to market product-lines into all terrain vehicles, recreational vehicles and motorcycles, as well as provides us with deep product knowledge into niche segments like Jeep, Volkswagen and trucks. This expansion of our product line increases our customer reach in the do-it-yourself automobile and off-road accessories market. For additional information, see *Note 5 Business Combination* of the Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report. We may pursue additional acquisition opportunities in the future to increase our share of the aftermarket auto parts market or expand our product offering.

Table of Contents

Executive Summary

We reported net sales for the quarter ended July 2, 2011 (Q2 2011) of $84.3 million compared with the quarter ended July 3, 2010 (Q2 2010) net sales of $53.2 million. Excluding $24.8 million of revenues from the acquisition of WAG, net sales were $59.5 million, an increase of 11.8% over Q2 2010 net sales. Q2 2010 net sales include the impact of a $2.0 million non-cash reduction of reported sales from a change in the Company s revenue recognition. Excluding the impact of the change in revenue recognition on Q2 2010 sales, net sales for Q2 2011 increased 7.8%. Q2 2011 net loss was $2.6 million or $0.08 per share, compared with Q2 2010 net income of $0.5 million or $0.01 per diluted share. Q2 2011 s net loss includes a net loss of $4.1 million or $0.13 per share related to WAG of which $1.5 million of the loss, net of tax was attributable to restructuring and integration expenses. We generated Adjusted EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization plus additional adjustments of current year s stock compensation, legal costs to enforce intellectual property rights, charge for change in revenue recognition, and restructuring expenses related to acquisition) of $4.6 million for the quarter compared to $5.0 million for Q2 2010. Excluding WAG s Adjusted EBITDA of $(0.6) million and related $1.5 million of restructuring and integration expenses as well as $0.2 million of legal fees to protect intellectual property; Adjusted EBITDA was $5.2 million, an increase of 3.8% over Q2 2010. Adjusted EBITDA is presented because such measure is used by rating agencies, securities analysts, investors and other parties in evaluating us. It should not be considered, however, as an alternative to operating income as an indicator of our operating performance or as an alternative to cash flows as measures of our overall liquidity as presented in our unaudited condensed consolidated financial statements. Further, Adjusted EBITDA measure shown for us may not be comparable to similarly titled measures used by other companies.

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

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

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

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

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

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Consolidated				
Net (loss) income	$ (2,564)	$ 462	$ (2,810)	$ 2,009
Interest expense (income), net	172	(34)	437	(55)
Income tax provision	195	225	213	1,175
Amortization of intangibles	1,363	124	2,990	245
Depreciation and amortization	3,072	1,950	6,075	3,934
EBITDA	2,238	2,727	6,905	7,308
Share-based compensation	643	612	1,324	1,472
	161	1,246	232	1,886

Legal costs to enforce intellectual property rights				
Charge for change in revenue recognition		411		411
Add back legal restructuring	4		26	
Add back other restructuring	1,538		2,749	
Adjusted EBITDA	$ 4,584	$ 4,996	$ 11,236	$ 11,077

Table of Contents

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
USAP excluding WAG				
Net income	$ 1,486	$ 462	$ 4,403	$ 2,009
Interest expense (income), net	173	(34)	439	(55)
Income tax provision	140	225	158	1,175
Amortization of intangibles	125	124	249	245
Depreciation and amortization	2,459	1,950	4,851	3,934
EBITDA	4,383	2,727	10,100	7,308
Share-based compensation	643	612	1,324	1,472
Legal costs to enforce intellectual property rights	161	1,246	232	1,886
Charge for change in revenue recognition		411		411
Adjusted EBITDA	$ 5,187	$ 4,996	$ 11,656	$ 11,077

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, intangible and other long-lived assets and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. There were no significant changes to our critical accounting policies during the twenty-six weeks ended July 2, 2011, as compared to those policies disclosed in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

Recent Accounting Pronouncements

In December 2010, the FASB issued ASU 2010-29, an update to ASC 805. The amendments in ASU 2010-29 specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments in ASU 2010-29 also expand the supplemental pro forma disclosures under ASC 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. We will apply the provisions of ASU 2010-29 to future acquisitions occur after January 2, 2011. We believe that the adoption will not have a material effect on our consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04), an update to ASC Topic 820, *Fair Value Measurement* (ASC 820). The amendments in ASU 2011-04 are the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework and provide converged guidance how to measure fair value and on what disclosures to provide about fair value measurements. While ASU 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands ASC 820 s existing disclosure requirements for fair value measurements and makes other amendments. Many of these amendments were made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards (IFRSs). However, some could change how the fair value measurement guidance in ASC 820 is applied. For public entities, amendments are effective for interim and annual periods beginning after December 15, 2011. We will adopt the provisions of ASU 2011-04 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. We believe that the adoption will not have a material effect on our consolidated financial statements.

Table of Contents

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), an update to ASC Topic 220, *Comprehensive Income* (ASC 220). The amendments in ASU 2011-05 revise the manner in which entities present comprehensive income in their financial statements by removing the presentation options in ASC 220 and requiring entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The amendments in ASU 2011-5 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. We will adopt the provisions of ASU 2011-05 on January 1, 2012, the starting date of its fiscal year ending December 29, 2012. This adoption will have an impact on the presentation of other comprehensive income on the Company s consolidated financial statements.

Results of Operations

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

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	66.3	65.4	65.6	65.1
Gross profit	33.7	34.6	34.4	34.9
Operating expenses:				
Marketing	17.0	13.5	16.3	13.1
General and administrative	10.0	12.0	9.7	11.1
Fulfillment	5.4	5.5	5.6	5.6
Technology	2.3	2.2	2.3	2.1
Amortization of intangibles	1.6	0.2	1.7	0.2
Total operating expenses	36.3	33.4	35.6	32.1
(Loss) income from operations	(2.6)	1.2	(1.2)	2.8
Other income (expense):				
Other income	0.0	0.0	0.0	0.0
Interest (expense) income	(0.2)	0.1	(0.3)	0.1
Total other (expense) income, net	(0.2)	0.1	(0.3)	0.1
(Loss) income before income taxes	(2.8)	1.3	(1.5)	2.9
Income tax provision	0.2	0.4	0.1	1.1
Net (loss) income	(3.0)%	0.9%	(1.6)%	1.8%

Thirteen and Twenty-Six Weeks Ended July 2, 2011 Compared to Thirteen and Twenty-Six Weeks Ended July 3, 2010

Net Sales and Gross Margin

	Thirteen Weeks Ended July 2, 2011	Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010
		(in thousands)		
Net sales	$ 84,268	$ 53,188	$ 171,246	$ 109,479

Cost of sales	55,854	34,791	112,416	71,275
Gross profit	$ 28,414	$ 18,397	$ 58,830	$ 38,204
Gross margin	33.7%	34.6%	34.4%	34.9%

Net sales increased $31.1 million or 58.4% for Q2 2011, compared to Q2 2010. Excluding the WAG acquisition and the change in the Company s revenue recognition in Q2 2010, net sales increased $4.3 million or 7.8% primarily due to a $2.6 million or 6.0% increase in e-commerce sales and a $0.6 million or 8.2% increase in online marketplace sales. Our e-commerce

22

Table of Contents

channel includes a network of e-commerce websites, supported by our call-center sales agents who generate cross-sell and up-sell opportunities. We also sell our products through our online marketplaces, which primarily consist of auction and other third-party websites. The increase in e-commerce sales for Q2 2011, compared to Q2 2010, resulted from a 9% increase in unique visitors, a 1% increase in revenue capture, which is the amount of dollars retained by us after taking into consideration any credit card declines, returns and product fulfillment, a 2% decline in average order value, and a 3% decline in conversion. Our conversion rate is the ratio of visitors who convert into placed orders.

Net sales increased $61.8 million or 56.4% for the twenty-six weeks ended July 2, 2011 (YTD Q2 2011), compared to the twenty-six weeks ended July 3, 2010 (YTD Q2 2010). Excluding the WAG acquisition and the change in the Company s revenue recognition in Q2 2010, net sales increased $11.8 million or 10.6% primarily due to a $10.4 million or 12.1% increase in e-commerce sales. The increase in e-commerce sales for YTD Q2 2011, compared to YTD Q2 2010, resulted from a 4% improvement in conversion, an 9% increase in unique visitors, and a 2% increase in revenue capture, partially offset by a 3% decline in average order value.

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

Gross profit increased $10.0 million or 54.5% during Q2 2011, compared to Q2 2010. Excluding the WAG acquisition, gross profit increased $1.8 million or 9.9%. Gross profit increased $20.6 million or 54.0% during YTD Q2 2011, compared to YTD Q2 2010. Excluding the WAG acquisition, gross profit increased $4.1 million or 10.7%. The increase in gross profit was primarily due to increased sales across all sales channels except for online marketplaces.

Gross margin decreased 0.9% to 33.7% of net sales during Q2 2011, compared with Q2 2010. Excluding the WAG acquisition, gross margin decreased 0.6% to 34.0% of net sales. Gross margin decreased 0.5% to 34.4% of net sales during YTD Q2 2011, compared with YTD Q2 2011. Excluding the WAG acquisition, gross margin decreased 0.6% to 34.3% of net sales. Gross margin was unfavorably impacted by a mix shift from body to engine parts partially offset by price increases in both body and engine parts.

Marketing Expense

	Thirteen Weeks Ended July 2, 2011		Thirteen Weeks Ended July 3, 2010	Twenty-Six Weeks Ended July 2, 2011	Twenty-Six Weeks Ended July 3, 2010					
		(in thousands)								
Marketing expense	$	14,366	$ 7,138	117,000	11/08/17	AUD	22.89	AUD	2,455	(10,313)
Boliden AB	UBS AG	38,500	11/09/17	SEK	280.06	SEK	10,636	(37,302)		
Elders, Ltd.	JPMorgan Chase Bank N.A.	46,700	11/09/17	AUD	4.55	AUD	226	(12,939)		
Elders, Ltd.	UBS AG	50,000	11/09/17	AUD	4.70	AUD	243	(9,590)		
Glencore PLC	Goldman Sachs International	867,800	11/09/17	GBP	3.55	GBP	2,977	(92,885)		
Boliden AB	UBS AG	52,600	11/10/17	SEK	273.87	SEK	14,532	(71,403)		
Rio Tinto PLC, ADR	Barclays Bank PLC	92,800	11/10/17	USD	49.10	USD	4,379	(71,860)		
Encana Corp.	Morgan Stanley & Co. International PLC	59,300	11/14/17	CAD	13.20	CAD	871	(82,068)		
BHP Billiton PLC	Credit Suisse International	327,500	11/16/17	GBP	13.81	GBP	4,313	(113,675)		
BHP Billiton PLC	Goldman Sachs International	53,700	11/16/17	GBP	13.38	GBP	707	(24,952)		
Boliden AB	Morgan Stanley & Co. International PLC	60,000	11/16/17	SEK	276.44	SEK	16,576	(76,894)		
Fresnillo PLC	Credit Suisse International	124,400	11/16/17	GBP	14.85	GBP	1,749	(46,777)		
Glanbia PLC	Citibank N.A.	16,100	11/16/17	EUR	16.74	EUR	257	(3,258)		
Glencore PLC	Credit Suisse International	852,100	11/16/17	GBP	3.57	GBP	2,923	(95,778)		

South32 Ltd.	Citibank N.A.	1,108,000	11/16/17	AUD	3.29	AUD	3,656	(123,582)
South32 Ltd.	UBS AG	916,000	11/16/17	AUD	3.26	AUD	3,023	(110,784)
Yara International ASA	Morgan Stanley & Co. International PLC	35,400	11/16/17	NOK	372.35	NOK	12,642	(34,675)
Cimarex Energy Co.	Morgan Stanley & Co. International PLC	21,400	11/20/17	USD	106.71	USD	2,433	(200,349)
Glanbia PLC	HSBC Bank PLC	20,000	11/20/17	EUR	16.34	EUR	319	(7,183)
Devon Energy Corp.	Credit Suisse International	22,900	11/27/17	USD	34.65	USD	841	(68,413)
Eni SpA, ADR	Bank of America N.A.	42,300	11/27/17	USD	33.00	USD	1,399	(31,832)
CF Industries Holdings, Inc.	Barclays Bank PLC	74,000	12/04/17	USD	35.60	USD	2,602	(137,114)
Elders, Ltd.	UBS AG	38,000	12/05/17	AUR	4.64	AUD	184	(9,665)
Elders, Ltd.	UBS AG	49,000	12/05/17	AUR	4.93	AUD	238	(5,969)
Glanbia PLC	Morgan Stanley & Co. International PLC	20,000	12/05/17	EUR	16.36	EUR	319	(8,463)
Yara International ASA	Goldman Sachs International	35,500	12/05/17	NOK	365.22	NOK	12,678	(55,693)
Cimarex Energy Co.	Morgan Stanley & Co. International PLC	13,300	12/07/17	USD	113.00	USD	1,512	(79,956)
Devon Energy Corp.	Credit Suisse International	22,900	12/11/17	USD	36.50	USD	841	(48,704)
Total								$ (3,750,913)

Consolidated Schedule of Investments (continued) **BlackRock Resources & Commodities Strategy Trust (BCX)**

Fair Value Hierarchy as of Period End

Various inputs are used in determining the fair value of investments and derivative financial instruments. These inputs to valuation techniques are categorized into a fair value hierarchy consisting of three broad levels for financial reporting purposes as follows:

Level 1 Unadjusted price quotations in active markets/exchanges for identical assets or liabilities that the Trust has the ability to access

Level 2 Other observable inputs (including, but not limited to, quoted prices for similar assets or liabilities in markets that are active, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the assets or liabilities (such as interest rates, yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates) or other market corroborated inputs)

Level 3 Unobservable inputs based on the best information available in the circumstances, to the extent observable inputs are not available (including the Trust s own assumptions used in determining the fair value of investments and derivative financial instruments)

The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Accordingly, the degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3. The inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the fair value hierarchy classification is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Investments classified within Level 3 have significant unobservable inputs used by the BlackRock Global Valuation Methodologies Committee (the Global Valuation Committee) in determining the price for Fair Valued Investments. Level 3 investments include equity or debt issued by privately held companies or funds. There may not be a secondary market, and/or there are a limited number of investors. Level 3 investments may also be adjusted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the Global Valuation Committee in the absence of market information.

Changes in valuation techniques may result in transfers into or out of an assigned level within the hierarchy. In accordance with the Trust s policy, transfers between different levels of the fair value hierarchy are deemed to have occurred as of the beginning of the reporting period. The categorization of a value determined for investments and derivative financial instruments is based on the pricing transparency of the investments and derivative financial instruments and is not necessarily an indication of the risks associated with investing in those securities. For information about the Trust s policy regarding valuation of investments and derivative financial instruments, refer to the Trust s most recent financial statements as contained in its annual report.

The following tables summarize the Trust s investments and derivative financial instruments categorized in the disclosure hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Long-Term Investments:				
Common Stocks:				
Chemicals	$ 141,197,157	$ 11,927,662		$ 153,124,819
Containers & Packaging	25,405,863			25,405,863
Energy Equipment & Services	32,945,320			32,945,320
Food Products	60,734,046	4,746,887		65,480,933
Metals & Mining	150,802,148	148,267,786		299,069,934
Oil, Gas & Consumable Fuels	361,719,111	6,516,330		368,235,441
Paper & Forest Products	10,678,751	117,726	$ 557,969	11,354,446
Corporate Bonds		9,357,453		9,357,453
Short-Term Investment Fund	19,090,150			19,090,150
Subtotal	$ 802,572,546	$ 180,933,844	$ 557,969	$ 984,064,359
Investments Valued at NAV[1]				954,119
Total	$ 802,572,546	$ 180,933,844	$ 557,969	$ 985,018,478

Derivative Financial Instruments[2]

Consolidated Schedule of Investments (concluded) **BlackRock Resources & Commodities Strategy Trust (BCX)**

Liabilities:			
Equity contracts	$ (8,293,734)	$ (4,703,636)	$ (12,997,370)

[1] As of September 30, 2017, certain of the Trust s investments were fair valued using NAV per share as no quoted market value is available and therefore have been excluded from the fair value hierarchy.

[2] Derivative financial instruments are options written, which are shown at value.

During the period ended September 30, 2017, there were no transfers between levels.

Item 2 Controls and Procedures

2(a) The registrant s principal executive and principal financial officers, or persons performing similar functions, have concluded that the registrant s disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended (the 1940 Act)) are effective as of a date within 90 days of the filing of this report based on the evaluation of these controls and procedures required by Rule 30a-3(b) under the 1940 Act and Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended.

2(b) There were no changes in the registrant s internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act) that occurred during the registrant s last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the registrant s internal control over financial reporting.

Item 3 Exhibits

Certifications Attached hereto

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BlackRock Resources & Commodities Strategy Trust

By: /s/ John M. Perlowski
John M. Perlowski
Chief Executive Officer (principal executive officer) of
BlackRock Resources & Commodities Strategy Trust

Date: November 20, 2017

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ John M. Perlowski
John M. Perlowski
Chief Executive Officer (principal executive officer) of
BlackRock Resources & Commodities Strategy Trust

Date: November 20, 2017

By: /s/ Neal J. Andrews
Neal J. Andrews
Chief Financial Officer (principal financial officer) of
BlackRock Resources & Commodities Strategy Trust

Date: November 20, 2017