

U.S. Auto Parts Network, Inc.
Form 10-K
March 13, 2019
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 K

(Mark One)

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

For the fiscal year ended December 29, 2018

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 (I.R.S. Employer

Incorporation or Organization) Identification No.)

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

16941 Keegan Avenue, Carson, CA 90746

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (424) 702 1455

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

Title of each class	Name of each exchange on which registered
Common Stock, \$0.001 par value per share	The NASDAQ Stock Market LLC
	(NASDAQ Global Market)

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted 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 such files). Yes No

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

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

Large accelerated filer	Accelerated filer
Non-Accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of

the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes No

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2018 was approximately \$40.8 million (based on the closing sales price of the registrant's common stock on that date). For the purposes of this calculation, shares owned by officers, directors and 10% stockholders known to the registrant have been deemed to be owned by affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 11, 2019, there were 35,412,555 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our proxy statement for the 2019 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as a part hereof.

Table of Contents

U.S. AUTO PARTS NETWORK, INC.
 ANNUAL REPORT ON FORM 10 K
 FOR THE FISCAL YEAR ENDED December 29, 2018

TABLE OF CONTENTS

	Page
<u>PART I</u>	1
<u>Item 1. Business</u>	1
<u>Item 1A. Risk Factors</u>	5
<u>Item 1B. Unresolved Staff Comments</u>	22
<u>Item 2. Properties</u>	22
<u>Item 3. Legal Proceedings</u>	22
<u>Item 4. Mine Safety Disclosures</u>	22
<u>PART II</u>	23
<u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	23
<u>Item 6. Selected Financial Data</u>	23
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	40
<u>Item 8. Financial Statements and Supplementary Data</u>	41
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	41
<u>Item 9A. Controls and Procedures</u>	41
<u>Item 9B. Other Information</u>	42
<u>PART III</u>	43
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	43
<u>Item 11. Executive Compensation</u>	43
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	43
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	43
<u>Item 14. Principal Accounting Fees and Services</u>	43
<u>PART IV</u>	44
<u>Item 15. Exhibits, Financial Statement Schedules</u>	44

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

U.S. Auto Parts®, U.S. Auto Parts Network™, Kool-Vue®, JC Whitney®, Carparts.com®, and Evan Fischer®, amongst others, are our United States trademarks. All other trademarks and trade names appearing in this report are

the property of their respective owners.

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

Table of Contents

PART I

ITEM 1. BUSINESS

Overview

We are a leading online provider of automotive aftermarket parts. Our vision is that vehicle repairs and upgrades are easy and affordable. Our mission is to provide an exceptionally easy experience for our customers. Our mantra is "make it easy for our customers." Our five core values are: customer focus, teamwork, integrity, quality, and continuous improvement.

We principally sell our products, identified as stock keeping units ("SKUs"), to individual consumers through our network of websites and online marketplaces. Our user-friendly websites provide customers with a comprehensive selection of over 1.5 million SKUs with detailed product descriptions, attributes and photographs. We have developed a proprietary product database that maps our SKUs to product applications based on vehicle makes, models and years.

Our online sales channel and relationships with suppliers enable us to eliminate intermediaries in the traditional auto parts supply chain and to offer a broader selection of SKUs than can easily be offered by offline competition.

We were incorporated in California in 1995 as a distributor of aftermarket auto parts and launched our first website in 2000. We reincorporated in Delaware in 2006 and expanded our online operations, increasing the number of SKUs sold through our e-commerce network, adding additional websites, improving our internet marketing proficiency, and commencing sales on online marketplaces. Like most e-commerce retailers, our success depends on our ability to attract online consumers to our websites and convert them into customers in a cost-effective manner. Our efforts to improve the website purchase experience for our online customers have included our efforts to: (1) help our customers find the parts they want to buy through a customized and guided shopping experience specific to key part names; (2) increase order size across our sites through improved recommendation engines; and (3) provide leading customer service and product support.

We intend to continue to implement strategies designed to build and increase our customer lifetime value by focusing on increasing gross profit after freight per transaction, transaction attachment rate, repeat purchases and conversion. We are in the process of adding resources to our marketing, user experience and technology teams to drive new investment in organic and paid search, retention marketing and improvements to our technology infrastructure. We also plan to restructure the organization to focus on our most prominent e-commerce websites and provide users of our sites with the same or better experience than they would receive on the marketplace sites. We will therefore be placing a significant effort on restructuring our data and catalog methodologies to enhance the discovery of products and make our catalog a stronger competitive advantage on our e-commerce sites. We expect to start to receive the benefits from some of these investments towards the end of the year. We are also taking steps to offset some of the freight and competitive pressure which have impacted our gross margin, including developing exclusive private label parts not readily available to our competitors, delivering improved customer experience and making changes to our supply chain by getting closer to the customer to realize freight savings.

Our flagship websites are located at www.autopartswarehouse.com, www.carparts.com, and www.jcwhitney.com and our corporate website is located at www.usautoparts.net.

We report on a 52/53 week fiscal year, ending on the Saturday nearest the end of December. References to 2018 and 2017 relate to the 52 week fiscal years ended December 29, 2018 and December 30, 2017.

Our Products

We offer a broad selection of aftermarket auto parts. We continually refine our product offering by introducing new brands and parts categories, while discontinuing low-selling brands and SKUs. We broadly classify our products into three subcategories by function: collision parts serving the body repair segment, engine parts to serve the replacement/wear parts market and performance parts and accessories.

Table of Contents

Collision Parts. The collision parts category is primarily comprised of parts for the exterior of an automobile. Our parts in this category are typically replacement parts for original body parts that have been damaged as a result of a collision or through general wear and tear. The majority of these products are sold through our websites. In addition, we sell an extensive line of mirror products, including our own private-label brand called Kool-Vue®, which are marketed and sold as aftermarket replacement parts and as upgrades to existing parts.

Engine Parts. The engine parts category is comprised of engine and chassis components as well as other mechanical and electrical parts, including our own private label brand of aftermarket catalytic converters called Evan Fischer®. These parts serve as replacement parts for existing engine parts and are generally used by professionals and do-it-yourselfers for engine and mechanical maintenance and repair.

Performance Parts and Accessories. We offer performance versions of many parts sold in each of the above categories. Performance parts and accessories generally consist of parts that enhance the performance of the automobile, upgrade existing functionality of a specific part or improve the physical appearance or comfort of the automobile.

Our Sales Channels

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

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

Offline Sales Channel. We sell and deliver to collision repair shops from our Chesapeake, Virginia warehouse facility. We also market our Kool-Vue® products nationwide to auto parts wholesale distributors and serve consumers by operating a retail outlet store in LaSalle, Illinois.

Our Fulfillment Operations

We fulfill customer orders using two primary methods: (1) stock-and-ship, where we take physical delivery of merchandise and store it in one of our distribution centers until it is shipped to a customer, and (2) drop-ship, where merchandise is shipped directly to customers from our suppliers. We believe that the flexibility of fulfilling orders using two different fulfillment methods allows us to offer a broader product selection, helps optimize product inventory and enhances our overall business profitability.

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

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

2

Table of Contents

Auto-Vend™ will process the order to the next appropriate vendor based on customer location, cost, contractual agreements, and service level history.

Suppliers

We source our products from two primary regions: (1) our private label product sourced primarily through manufacturers and distributors in the Asia-Pacific region, and (2) our branded product sourced primarily through drop-ship manufacturers and distributors located in the United States.

Private Label Product. Our private label suppliers offer products which are generally less expensive and we believe provide better value for our consumers. As a result, our mix shift towards private label product has continued to increase on a year-over-year basis. We stock-and-ship our private label products in our distribution centers. We currently have over 55,000 private label SKUs in our product selection.

Branded Product. We have developed and implemented application programming interfaces with the majority of our branded, drop ship suppliers that allow us to electronically transmit orders, check inventory availability, and receive the shipment tracking information which is easily passed on to our customers. We are a significant customer for many of our drop-ship vendors and have long standing relationships and contracts with many of these suppliers. For the fiscal year ended December 29, 2018, three of our drop-ship vendors accounted for approximately 11% of our total product purchases. We currently have over 1.5 million branded SKUs in our product selection.

Marketing

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

International Operations

In April 2007, we established offshore operations in the Philippines. Our offshore operations allow us to access a workforce with the necessary technical skills at a significantly lower cost than comparably experienced U.S.-based professionals. Our offshore operations are responsible for a majority of our website development, catalog management, and back office support. Our offshore operations also house our main call center. We had 701 employees in the Philippines as of December 29, 2018. We also primarily source our private label product from suppliers in the Asia-Pacific region.

Competition

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

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

- large online marketplaces such as Amazon.com and sellers on eBay;

3

Table of Contents

- other online retailers of automotive products and auto repair information websites;
- local independent retailers or niche auto parts retailers;
- wholesale aftermarket auto parts distributors such as LKQ Corporation; and
- manufacturers, brand suppliers and other distributors selling online directly to consumers.

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

Government Regulation

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

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

Seasonality

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

Table of Contents

Employees

As of December 29, 2018, we had 353 employees in the United States and 701 employees in the Philippines for a total of 1,054 employees. None of our employees are represented by a labor union, and we have never experienced a work stoppage.

Available Information

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

ITEM 1A. RISK FACTORS

Our business is subject to a number of risks which are discussed below. Other risks are presented elsewhere in this report and in our other filings with the SEC. You should consider carefully the following risks in addition to the other information contained in this report and our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K, and any amendments thereto, before deciding to buy, sell or hold our common stock. If any of the following known or unknown risks or uncertainties actually occurs with material adverse effects on us, our business, financial condition, results of operations and/or liquidity could be seriously harmed. In that event, the market price for our common stock will likely decline and you may lose all or part of your investment.

Risks Related To Our Business

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

The online market for aftermarket auto parts is less developed than the online market for many other business and consumer products, and currently represents only a small part of the overall aftermarket auto parts market. Our success will depend in part on our ability to attract new customers and to convert customers who have historically purchased auto parts through traditional retail and wholesale operations. Specific factors that could discourage or prevent prospective customers from purchasing from us include:

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

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

Table of Contents

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

Our success depends on our ability to attract customers in a cost-effective manner. Our investments in marketing may not effectively reach potential consumers or those consumers may not decide to buy from us or the volume of consumers that purchase from us may not yield the intended return on investment. With respect to our marketing channels, we rely on relationships with providers of online services, search engines, shopping comparison sites and e-commerce businesses to provide content, advertising banners and other links that direct customers to our websites. We rely on these relationships as significant sources of traffic to our websites. In particular, we rely on Google as an important marketing channel, and if Google changes its algorithms or if competition increases for advertisements on Google or on our marketplace channels, we may be unable to cost-effectively attract customers to our products.

Our agreements with our marketing providers generally have terms of one year or less. If we are unable to develop or maintain these relationships on acceptable terms, our ability to attract new customers would be harmed. In addition, many of the parties with whom we have online-advertising arrangements could provide advertising services to other companies, including retailers with whom we compete. As competition for online advertising has increased, the cost for these services has also increased. A significant increase in the cost of the marketing vehicles upon which we rely could adversely impact our ability to attract customers in a cost-effective manner and harm our business and results of operations. Further, we use promotions as a way to drive sales, these promotional activities may not drive sales and may adversely affect our gross margins.

Similarly, if any free search engine, shopping comparison site, or marketplace site on which we rely begins charging fees for listing or placement, or if one or more of the search engines, shopping comparison sites, marketplace sites and other online sources on which we rely for purchased listings, increases their fees, or modifies or terminates its relationship with us, our expenses could rise, we could lose customers and traffic to our websites could decrease.

Shifting online consumer behavior of purchasers of aftermarket auto parts could adversely impact our financial results and the growth of our business.

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

In addition, shifting consumer behavior indicates that customers may be more inclined to shop for aftermarket auto parts through marketplace websites such as Amazon and eBay as opposed to purchasing parts through e-commerce channels. For example, the online marketplaces sales grew from 26.5% of total sales in fiscal 2016 to 35.0% of total sales in fiscal 2017 and 36.0% of total sales during fiscal 2018. Any mix shift in sales to marketplace channels could result in lower gross margins, and as a result, our business and financial results may suffer.

During fiscal 2018, we recorded a net loss, and our net losses may continue in fiscal year 2019.

During fiscal 2018, we incurred a net loss of \$4,889, compared to net income of \$24,015 for fiscal 2017, attributable in large part to a \$21,540 income tax benefit resulting from a change in valuation allowance, in addition to the impact of the Tax Cuts and Jobs Act. If our net losses continue in fiscal year 2019, they could severely impact our liquidity,

as we may not be able to provide positive cash flows from operations in order to meet our working capital requirements. We may need to borrow additional funds from our credit facility, which under certain circumstances may not be available, sell additional assets or seek additional equity or additional debt financing in the future. In such case, there can be no assurance that we would be able to raise such additional financing or engage in such asset sales on acceptable terms, or

6

Table of Contents

at all. If our net losses were to continue, and if we are not able to raise adequate additional financing or proceeds from asset sales to continue to fund our ongoing operations, we will need to defer, reduce or eliminate significant planned expenditures, restructure or significantly curtail our operations, file for bankruptcy or cease operations.

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

We maintain an asset-based revolving credit facility with JPMorgan Chase Bank, N.A. (the “Credit Agreement”) that provides for, among other things, a revolving commitment in an aggregate principal amount of up to \$30 million subject to a borrowing base derived from certain of our receivables, inventory and property and equipment. Our Credit Agreement includes a number of restrictive covenants. These covenants could impair our financing and operational flexibility and make it difficult for us to react to market conditions and satisfy our ongoing capital needs and unanticipated cash requirements. Specifically, such covenants restrict our ability and, if applicable, the ability of our subsidiaries to, among other things:

- incur additional debt;
- make certain investments and acquisitions;
- enter into certain types of transactions with affiliates;
- use assets as security in other transactions;
- pay dividends on our capital stock or repurchase our equity interests, excluding payments of preferred stock dividends which are specifically permitted under our credit facility;
- sell certain assets or merge with or into other companies;
- guarantee the debts of others;
- enter into new lines of business;
- pay or amend our subordinated debt; and
- form any joint ventures or subsidiary investments.

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

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

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

Table of Contents

and our debt is accelerated, a material adverse effect on our financial condition and future operating performance would result.

While we did not have any outstanding revolver debt under our Credit Agreement as of the end of fiscal 2018, we may have outstanding revolver debt in the future. Any outstanding indebtedness would have important consequences, including the following:

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

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

We face exposure to product liability lawsuits.

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

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

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

Table of Contents

We are highly dependent upon key suppliers.

Our top ten suppliers represented approximately 47% of our total product purchases during fiscal 2018. Our ability to acquire products from our suppliers in amounts and on terms acceptable to us is dependent upon a number of factors that could affect our suppliers and which are beyond our control. For example, financial or operational difficulties that some of our suppliers may face could result in an increase in the cost of the products we purchase from them. If we do not maintain our relationships with our existing suppliers or develop relationships with new suppliers on acceptable commercial terms, we may not be able to continue to offer a broad selection of merchandise at competitive prices and, as a result, we could lose customers and our sales could decline.

For a number of the products that we sell, we outsource the distribution and fulfillment operation and are dependent on certain drop-ship suppliers to manage inventory, process orders and distribute those products to our customers in a timely manner. For fiscal 2018, our product purchases from three drop-ship suppliers represented approximately 11% of our total product purchases. Because we outsource to suppliers a number of these traditional retail functions relating to those products, we have limited control over how and when orders are fulfilled. We also have limited control over the products that our suppliers purchase or keep in stock. Our suppliers may not accurately forecast the products that will be in high demand or they may allocate popular products to other resellers, resulting in the unavailability of certain products for delivery to our customers. Any inability to offer a broad array of products at competitive prices and any failure to deliver those products to our customers in a timely and accurate manner may damage our reputation and brand and could cause us to lose customers and our sales could decline.

In addition, the increasing consolidation among auto parts suppliers may disrupt or end our relationship with some suppliers, result in product shortages and/or lead to less competition and, consequently, higher prices. Furthermore, as part of our routine business, suppliers extend credit to us in connection with our purchase of their products. In the future, our suppliers may limit the amount of credit they are willing to extend to us in connection with our purchase of their products. If this were to occur, it could impair our ability to acquire the types and quantities of products that we desire from the applicable suppliers on acceptable terms, severely impact our liquidity and capital resources, limit our ability to operate our business and could have a material adverse effect on our financial condition and results of operations.

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

We acquire a majority of our products from manufacturers and distributors located in Taiwan and China. We do not have any long-term contracts or exclusive agreements with our foreign suppliers that would ensure our ability to acquire the types and quantities of products we desire at acceptable prices and in a timely manner or that would allow us to rely on customary indemnification protection with respect to any third party claims similar to some of our U.S. suppliers.

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

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

Table of Contents

the failure of local laws to provide a sufficient degree of protection against infringement of our intellectual property.

For example, during the first quarter of 2018, the United States Customs and Border Protection (“CBP”) imposed an enhanced bonding requirement on the company at a level equivalent to three times the commercial invoice value of each shipment. While the Company has been granted relief removing the bonding requirement, CBP may impose other requirements on the Company which would make it more difficult or more expensive for the Company to import products. If we were unable to import products from China and Taiwan or were unable to import products from China and Taiwan in a cost-effective manner, we could suffer irreparable harm to our business and be required to significantly curtail our operations, file for bankruptcy or cease operations.

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

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

We rely on third parties for the shipment of our products and we cannot be sure that these relationships will continue on terms favorable to us, or at all. Shipping costs have increased from time to time, and may continue to increase, and we may not be able to pass these costs directly to our customers. Any increased shipping costs could harm our business, prospects, financial condition and results of operations by increasing our costs of doing business and reducing gross margins which could negatively affect our operating results. In addition, we utilize a variety of shipping methods for both inbound and outbound logistics. For inbound logistics, we rely on trucking and ocean carriers and any increases in fees that they charge could adversely affect our business and financial condition. For outbound logistics, we rely on “Less-than-Truckload” (“LTL”) and parcel freight based upon the product and quantities being shipped and customer delivery requirements. These outbound freight costs have increased on a year-over-year basis and may continue to increase in the future. We also ship a number of oversized auto parts which may trigger additional shipping costs by third party delivery services. Any increases in fees or any increased use of LTL would increase our shipping costs which could negatively affect our operating results.

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

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

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

Table of Contents

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

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

- difficulties and costs of staffing and managing foreign operations, including any impairment to our relationship with employees caused by a reduction in force;
- restrictions imposed by local labor practices and laws on our business and operations;
- exposure to different business practices and legal standards;
- unexpected changes in regulatory requirements;
- the imposition of government controls and restrictions;
- political, social and economic instability and the risk of war, terrorist activities or other international incidents;
- the failure of telecommunications and connectivity infrastructure;
- natural disasters and public health emergencies;
- potentially adverse tax consequences; and
- fluctuations in foreign currency exchange rates and relative weakness in the U.S. dollar.

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

Our success depends on our ability to successfully receive and fulfill orders and to promptly deliver our products to our customers. The majority of orders for our auto collision parts products are filled from our inventory in our distribution centers, where all our inventory management, packaging, labeling and product return processes are performed. Increased demand and other considerations may require us to expand our distribution centers or transfer our fulfillment operations to larger or other facilities in the future. If we do not successfully expand our fulfillment capabilities in response to increases in demand, our sales could decline.

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

Table of Contents

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

We rely on third-party vendors, including data center and bandwidth providers. Any disruption in the network access or co-location services, which are the services that house and provide Internet access to our servers, provided by these third-party providers or any failure of these third-party providers to handle current or higher volumes of use could significantly harm our business. Any financial or other difficulties our providers face may have negative effects on our business, the nature and extent of which we cannot predict. We exercise little control over these third-party vendors, which increases our vulnerability to problems with the services they provide. We also license technology and related databases from third parties to facilitate elements of our e-commerce platform. We have experienced and expect to continue to experience interruptions and delays in service and availability for these elements. Any errors, failures, interruptions or delays experienced in connection with these third-party technologies could negatively impact our relationship with our customers and adversely affect our business. Our systems also heavily depend on the availability of electricity, which also comes from third-party providers. If we were to experience a major power outage, we would have to rely on back-up generators. These back-up generators may not operate properly through a major power outage, and their fuel supply could also be inadequate during a major power outage. Information systems such as ours may be disrupted by even brief power outages, or by the fluctuations in power resulting from switches to and from backup generators. This could disrupt our business and cause us to lose customers.

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

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

In addition, any failure by us to comply with applicable privacy and information security laws and regulations could cause us to incur significant costs to protect any customers whose personal data was compromised and to restore customer confidence in us and to make changes to our information systems and administrative processes to address security issues and compliance with applicable laws and regulations. In addition, our customers could lose confidence in our ability to protect their personal information, which could cause them to stop shopping on our sites altogether. Such events could lead to lost sales and adversely affect our results of operations. We also could be exposed to government enforcement actions and private litigation.

Moreover, we are subject to the Payment Card Industry Data Security Standard ("PCI DSS"), issued by the PCI Council. PCI DSS contains compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. We cannot be certain that all of our information technology systems are able to prevent, contain or detect any cyber-attacks, cyber terrorism, or security breaches from known malware or malware that may be developed in the future. To the extent that any disruption results in the loss, damage or misappropriation of information, we may be materially adversely affected by claims from customers, financial institutions, regulatory authorities, payment card associations and others. In addition, the cost of complying with stricter privacy and information security laws and standards could be significant to us. For example, we were recently required to transition from PCI Data Security Standard 2.0 to PCI Data Security Standard

3.2. We are in the process of conforming to the new standards which we expect to be completed this year. There is no guarantee that we will be able to conform to these new standards, and if we fail to meet these standards, we could become subject to fines and other penalties and experience a significant increase in payment card transaction costs. In addition, such failure could damage our reputation, inhibit sales, and adversely affect our business.

12

Table of Contents

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

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

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

Barriers to entry are low, and current and new competitors can launch websites at a relatively low cost. Many of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing, technical, management and other resources than we do. For example, in the event that online marketplace companies such as Amazon or eBay, who have larger customer bases, greater brand recognition and significantly greater resources than we do, focus more of their resources on competing in the aftermarket auto parts market, it could have a material adverse effect on our business and results of operations. In addition, some of our competitors have used and may continue to use aggressive pricing tactics and devote substantially more financial resources to website and system development than we do. We expect that competition will further intensify in the future as Internet use and online commerce continue to grow worldwide. Increased competition may result in reduced sales, lower operating margins, reduced profitability, loss of market share and diminished brand recognition.

Additionally, we have experienced significant competitive pressure from certain of our suppliers who are now selling their products directly to customers. Since our suppliers have access to merchandise at very low costs, they can sell products at lower prices and maintain higher gross margins on their product sales than we can. Our financial results have been negatively impacted by direct sales from our suppliers to our current and potential customers, and our total number of orders and average order value may decline due to increased competition. Continued competition from our suppliers may also continue to negatively impact our business and results of operations, including through reduced sales, lower operating margins, reduced profitability, loss of market share and diminished brand recognition. We have implemented and will continue to implement several strategies to attempt to overcome the challenges created by our suppliers selling directly to our customers and potential customers, including optimizing our pricing, continuing to increase our mix of private label products and improving our websites, which may not be successful. If these strategies are not successful, our operating results and financial conditions could be materially and adversely affected.

If we fail to offer a broad selection of products at competitive prices or fail to maintain sufficient inventory to meet customer demands, our revenue could decline.

In order to expand our business, we must successfully offer, on a continuous basis, a broad selection of auto parts that meet the needs of our customers, including by being the first to market with new SKUs. Our auto parts are used by consumers for a variety of purposes, including repair, performance, improved aesthetics and functionality. In addition, to be successful, our product offerings must be broad and deep in scope, competitively priced, well-made, innovative and attractive to a wide range of consumers. We cannot predict with certainty that we will be successful in offering products

Table of Contents

that meet all of these requirements. Moreover, even if we offer a broad selection of products at competitive prices, we must maintain sufficient in-stock inventory to meet consumer demand. If our product offerings fail to satisfy our customers' requirements or respond to changes in customer preferences or we otherwise fail to maintain sufficient in-stock inventory, our revenue could decline.

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

OEMs have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEMs have brought such claims in federal court and with the United States International Trade Commission. We have received in the past, and we anticipate we may in the future receive, communications alleging that certain products we sell infringe the patents, copyrights, trademarks and trade names or other intellectual property rights of OEMs or other third parties. For instance, after approximately three and a half years of litigation and related costs and expenses, on April 16, 2009, we entered into a settlement agreement with Ford Motor Company and Ford Global Technologies, LLC that ended the two legal actions that were initiated by Ford against us related to claims of patent infringement. The United States Patent and Trademark Office records indicate that OEMs are seeking and obtaining more design patents and trademarks than they have in the past. During the past year, for example, the CBP has alleged that certain repair grilles imported by the Company are counterfeit and infringe on trademarks registered by OEMs. While the Company does not believe the trademarks are enforceable against it, the Company has ceased importing certain automotive grilles to avoid disruption to its supply chain. If the Company cannot work out a settlement with CBP, or otherwise locate a cost effective alternative to acquire certain aftermarket grilles, we may be unable to sell some of this product category which may result in a decline in revenue. In addition, to the extent that the OEMs are successful in obtaining and enforcing other intellectual property rights, we could be restricted or prohibited from selling other aftermarket products which could have an adverse effect on our business. Infringement claims could also result in increased costs of doing business arising from new importing requirements, increased port and carrier fees and legal expenses, adverse judgments or settlements or changes to our business practices required to settle such claims or satisfy any judgments. For example, during fiscal 2018 we incurred approximately \$5,046 of port and carrier fees and legal expenses attributable to CBP's wrongful seizures and the Company's litigation with CBP. Litigation or regulatory enforcement could also result in interpretations of the law that require us to change our business practices or otherwise increase our costs and harm our business. We may not maintain sufficient insurance coverage to cover the types of claims that could be asserted. If a successful claim were brought against us, it could expose us to significant liability.

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

We regard our trademarks, trade secrets and similar intellectual property such as our proprietary back-end order processing and fulfillment code and process as important to our success. We rely on trademark and copyright law, and trade secret protection, and confidentiality and/or license agreements with employees, customers, partners and others to protect our proprietary rights. We cannot be certain that we have taken adequate steps to protect our proprietary rights, especially in countries where the laws may not protect our rights as fully as in the United States. In addition, our proprietary rights may be infringed or misappropriated, and we could be required to incur significant expenses to preserve them. In the past we have filed litigation to protect our intellectual property rights. The outcome of such litigation can be uncertain, and the cost of prosecuting such litigation may have an adverse impact on our earnings. We have common law trademarks, as well as pending federal trademark registrations for several marks and several registered marks. However, any registrations may not adequately cover our intellectual property or protect us against infringement by others. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our products and services may be made available online. We also currently own or control a number of Internet domain names, including www.usautoparts.net, www.carparts.com,

www.autopartswarehouse.com, and www.jcwhitney.com, and have invested time and money in the purchase of domain names and other intellectual property, which may be impaired if we cannot protect such intellectual property. We may be unable to protect these domain names or acquire or maintain relevant domain names in the United States and in other countries. If we are not able to protect our trademarks, domain names or other intellectual property, we may experience difficulties in achieving and maintaining brand recognition and customer loyalty.

Table of Contents

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

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

As a result of our international operations, we have foreign exchange risk.

Our purchases of auto parts from our Asian suppliers are denominated in U.S. dollars; however, a change in the foreign currency exchange rates could impact our product costs over time. Our financial reporting currency is the U.S. dollar and changes in exchange rates significantly affect our reported results and consolidated trends. For example, if the U.S. dollar weakens year-over-year relative to currencies in our international locations, our consolidated gross profit and operating expenses would be higher than if currencies had remained constant. Similarly, our operating expenses in the Philippines are generally paid in Philippine Pesos, and as the exchange rate fluctuates, it could adversely impact our operating results.

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

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

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

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

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

Our sales would decline and we could lose existing or potential customers if they are not able to access our websites or if our websites, transactions processing systems or network infrastructure do not perform to our customers’

satisfaction. Any Internet network interruptions or problems with our websites could:

- prevent customers from accessing our websites;
- reduce our ability to fulfill orders or bill customers;

15

Table of Contents

- reduce the number of products that we sell;
- cause customer dissatisfaction; or
- damage our brand and reputation.

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

Risks Related To Our Capital Stock

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

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

Since the completion of our initial public offering in February 2007 through December 29, 2018, the trading price of our common stock has been volatile, ranging from a high of \$12.61 per share to a low per share of \$0.88. We have also experienced significant fluctuations in the trading volume of our common stock. General economic and political conditions unrelated to our performance may also adversely affect the price of our common stock. In the past, following periods of volatility in the market price of a public company's securities, securities class action litigation has often been initiated. Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of any such litigation if it were initiated. The initiation of any such litigation or an unfavorable result could have a material adverse effect on our financial condition and results of operations.

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

NASDAQ imposes, among other requirements, continued listing standards including minimum bid and public float requirements. The price of our common stock must trade at or above \$1.00 to comply with NASDAQ's minimum bid requirement for continued listing on the NASDAQ. If our stock trades at bid prices of less than \$1.00 for a period in excess of 30 consecutive business days, the NASDAQ could send a deficiency notice to us for not remaining in compliance with the minimum bid listing standards. While our common stock has not recently traded below \$1.00 for a sustained period, if the closing bid price of our common stock were to fail to meet NASDAQ's minimum closing bid

Table of Contents

price requirement, or if we otherwise fail to meet any other applicable requirements of the NASDAQ and we are unable to regain compliance, NASDAQ may make a determination to delist our common stock.

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

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

In March 2013, our Board of Directors, under the authority granted by our Certificate of Incorporation, established a series of preferred stock, our Series A Convertible Preferred, which has various rights, preferences and privileges senior to the shares of our common stock. Dividends on the Series A Convertible Preferred are payable quarterly, subject to the satisfaction of certain conditions, at a rate of \$0.058 per share per annum in cash, in shares of common stock or in any combination of cash and common stock as determined by our Board of Directors. While we may, at our election, subject to the satisfaction of certain conditions, pay any accrued but unpaid dividends on the Series A Convertible Preferred in either cash or in common stock, we may be unable to satisfy the requisite conditions for paying dividends in common stock and, under such circumstances, we will be required to pay such accrued but unpaid dividends in cash. In such circumstances, we will be required to use cash that would otherwise be used to fund our ongoing operations to pay such accrued but unpaid dividends. To the extent we do pay dividends in common stock as we have done in certain prior periods, the ownership percentage of our common stockholders who are not holders of the Series A Convertible Preferred will be diluted. Our Series A Convertible Preferred is initially convertible for 2,770,687 shares of common stock, and to the extent that the Series A Convertible Preferred is converted, the common stock ownership percentage of our common stockholders who are not converting holders of the Series A Convertible Preferred will be diluted.

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

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

- fluctuations in the demand for aftermarket auto parts;
- price competition on the Internet or among offline retailers for auto parts;
- our ability to attract visitors to our websites and convert those visitors into customers, including to the extent based on our ability to successfully work with different search engines to drive visitors to our websites;
 - our ability to successfully sell our products through third-party online marketplaces or the effects of any price increases in those marketplaces;
- competition from companies that have longer operating histories, larger customer bases, greater brand recognition, access to merchandise at lower costs and significantly greater resources than we do, like third-party online market places and our suppliers;
- our ability to maintain and expand our supplier and distribution relationships without significant price increases or reduced service levels;
- our ability to borrow funds under our credit facility;

Table of Contents

- the effects of seasonality on the demand for our products;
- our ability to accurately forecast demand for our products, price our products at market rates and maintain appropriate inventory levels;
- our ability to build and maintain customer loyalty;
- our ability to successfully integrate our acquisitions;
- infringement actions that could impact the viability of the auto parts aftermarket or portions thereof;
- the success of our brand-building and marketing campaigns;
- our ability to accurately project our future revenues, earnings, and results of operations;
- government regulations related to use of the Internet for commerce, including the application of existing tax regulations to Internet commerce and changes in tax regulations;
- technical difficulties, system downtime or Internet brownouts;
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure; and
 - macroeconomic conditions that adversely impact the general and automotive retail sales environment.

Our management has identified an internal control deficiency, which our management believes constitutes a material weakness. Any future material weaknesses or deficiencies in our internal control over financial reporting could harm our ability to accurately report our financial results, and our stock price could decline.

In connection with the preparation of our audited financial statements for the year ended December 29, 2018, we concluded that a material weakness existed in internal control over financial reporting related to the review over the accounting for significant and unusual transactions. Specifically, our management concluded that we had improperly accounted for abnormal freight costs related to our customs issues by amortizing them over the life of the inventory, as opposed to expensing them as period costs when incurred. In addition, certain impacts of the Tax Cuts and Jobs Act related to interest deduction limitations were incorrectly calculated in our initial tax provision. We are in the process of implementing controls to prevent these types of misstatements from occurring again. However, although we are committed to continuing to improve our internal control processes, and although we will continue to diligently and vigorously review our internal control over financial reporting, any control system, regardless of how well designed, operated and evaluated, can provide only reasonable, not absolute, assurance that its objectives will be met. Therefore, we cannot be certain that, in the future, additional material weaknesses or significant deficiencies will not exist or otherwise be discovered. If our efforts to address the weakness identified are not successful, or if other deficiencies occur, these weaknesses or deficiencies could result in misstatements of our results of operations, restatements of our financial statements, a decline in our stock price and investor confidence or other material effects on our business, reputation, results of operations, financial condition or liquidity.

Table of Contents

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

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

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

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

We currently do not expect to pay any cash dividends on our common stock for the foreseeable future.

General Market and Industry Risk

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

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

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

We have historically experienced higher sales of collision parts in winter months when inclement weather and hazardous road conditions typically result in more automobile collisions. Engine parts and performance parts and

Table of Contents

accessories have historically experienced higher sales in the summer months when consumers have more time to undertake elective projects to maintain and enhance the performance of their automobiles and the warmer weather during that time is conducive for such projects. We also have experienced increased demand following the issuance of tax rebates by the government. If we do not stock or restock popular products in sufficient amounts such that we fail to meet increased customer demand, it could significantly affect our revenue and our future growth. Likewise, if we overstock products in anticipation of increased demand, we may be required to take significant inventory markdowns or write-offs and incur commitment costs, which could reduce profitability.

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

We and our industry depend on the number of vehicle miles driven, vehicle accident rates and insurance companies' willingness to accept a variety of types of replacement parts in the repair process. Decreased miles driven reduce the number of accidents and corresponding demand for crash parts, and reduce the wear and tear on vehicles with a corresponding reduction in demand for vehicle repairs and replacement or engine parts. If consumers were to drive less in the future and/or accident rates were to decline, as a result of higher gas prices, increased use of ride-shares, the advancement of driver assistance technologies, or otherwise, our sales may decline and our business and financial results may suffer.

We will be required to collect and pay more sales taxes, and could become liable for other fees and penalties, which could have an adverse effect on our business.

We have historically collected sales or other similar taxes only on the shipment of goods to customers in the states of California, Virginia, Illinois, and Ohio. However, following the recent Supreme Court decision in *South Dakota v. Wayfair*, the Company will now be required to collect sales tax in any state which passes legislation requiring out of state retailers to collect sales tax even where they have no physical nexus. We have historically enjoyed a competitive advantage to the extent our competitors are already subject to those tax obligations. By collecting sales tax in additional states, we will lose this competitive advantage as total costs to our customers will increase, which could adversely affect our sales.

Moreover, if we fail to collect and remit or pay required sales or other taxes in a jurisdiction, or qualify or register to do business in a jurisdiction that requires us to do so or if we have failed to do so in the past, we could face material liabilities for taxes, fees, interest and penalties. If various jurisdictions impose new tax obligations on our business activities, our sales and net income in those jurisdictions could decrease significantly, which could harm our business.

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

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

Table of Contents

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

We are subject to federal and state consumer protection laws and regulations, including laws protecting the privacy of customer non-public information and regulations prohibiting unfair and deceptive trade practices, as well as laws and regulations governing businesses in general and the Internet and e-commerce and certain environmental laws. Additional laws and regulations may be adopted with respect to the Internet, the effect of which on e-commerce is uncertain. These laws may cover issues such as user privacy, spyware and the tracking of consumer activities, marketing e-mails and communications, other advertising and promotional practices, money transfers, pricing, content and quality of products and services, taxation, electronic contracts and other communications, intellectual property rights, and information security. Furthermore, it is not clear how existing laws such as those governing issues such as property ownership, sales and other taxes, trespass, data mining and collection, and personal privacy apply to the Internet and e-commerce. To the extent we expand into international markets, we will be faced with complying with local laws and regulations, some of which may be materially different than U.S. laws and regulations. Any such foreign law or regulation, any new U.S. law or regulation, or the interpretation or application of existing laws and regulations to the Internet or other online services or our business in general, may have a material adverse effect on our business, prospects, financial condition and results of operations by, among other things, impeding the growth of the Internet, subjecting us to fines, penalties, damages or other liabilities, requiring costly changes in our business operations and practices, and reducing customer demand for our products and services. We may not maintain sufficient insurance coverage to cover the types of claims or liabilities that could arise as a result of such regulation.

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

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

If significant tariffs or other restrictions are placed on Chinese imports or any related counter-measures are taken by China, our revenue and results of operations may be materially harmed.

If significant tariffs or other restrictions are placed on Chinese imports or any related counter-measures are taken by China, our revenue and results of operations may be materially harmed. In 2018, the Trump Administration implemented tariffs on thousands of categories of goods, including certain automotive parts. As a result, certain of our automotive imports to the United States are subject to a 10% tariff assessed on the cost of goods as imported. As a result of these tariffs, we may be required to raise our prices, which may result in the loss of customers and harm our operating performance. Additionally, the Trump Administration continues to signal that it may alter trade agreements and terms between China and the United States, including limiting trade with China, and may impose additional tariffs

on imports from China. If further tariffs are imposed on imports of our products, or retaliatory trade measures are taken by China or other countries in response to existing or future tariffs, we could be forced to raise prices on all of our imported products or make changes to our operations, any of which could materially harm our revenue or operating results.

Table of Contents

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 29, 2018, the total square footage of our leased office and distribution centers was 574,000 square feet. This includes approximately 531,000 square feet for our corporate headquarters located in Carson, California and distribution centers in LaSalle, Illinois and Chesapeake, Virginia; and approximately 43,000 square feet of office space in the Philippines. For additional information regarding our obligations under property leases, see “Note 8 Commitments and Contingencies” of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report.

ITEM 3. LEGAL PROCEEDINGS

The information set forth under the caption “Legal Matters” in “Note 8 Commitments and Contingencies” of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, and is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled “Risk Factors” in Item 1A of this report.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

22

Table of Contents

PART II

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

Market Information

Our common stock trades on the Nasdaq under the symbol "PRTS."

Holdings

As of March 11, 2019, there were approximately 20 registered shareholders of record of our common stock.

Dividend Policy

No dividends on common stock were paid during the fiscal year ended December 29, 2018. We issued approximately \$161,000 in cash dividends to our Series A Preferred stockholders during the fiscal year ended December 29, 2018 and issued approximately \$209,000 in cash dividends to our Series A Preferred stockholders during the fiscal year ended December 30, 2017. We do not anticipate that we will declare or pay any cash dividends on our common stock in the foreseeable future; however, we will have to pay dividends to our preferred stockholders until such shares are redeemed or converted. We maintain an asset-based revolving credit facility with JPMorgan Chase Bank (the "Credit Agreement") that provides for, among other things, a revolving commitment in an aggregate principal amount of up to \$30 million subject to a borrowing base derived from certain of our receivables, inventory and property and equipment. The Credit Agreement requires us to obtain a prior written consent from JPMorgan Chase Bank when we determine to pay any dividends on or make any distribution with respect to our common stock. Under the Second Amendment to Credit Agreement dated March 25, 2013, we obtained written consent from JPMorgan Chase Bank to pay dividends on our Series A Preferred Shares. See "Liquidity and Capital Resources" in Item 7 of Part II included in this report for further information on the covenants under the secured Credit Agreement. Any future determination to pay cash dividends on our common stock will be subject to the above restriction, as well as restrictions under any other existing indebtedness, at the discretion of our Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, and other factors the Board of Directors deems relevant.

Recent Sales of Unregistered Securities

None.

Use of Proceeds from Sales of Registered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

ITEM 6. SELECTED FINANCIAL DATA

As a smaller reporting company as defined by Rule 12b-2 of the Exchange Act, we are not required to provide the information under this item.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Dollar Amounts in Thousands, Except Per Share Data, or as Otherwise Noted)

Cautionary Statement

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto contained in Part IV, Item 15 of this report. Certain statements in this report, including statements regarding our business strategies, operations, financial condition, and prospects are forward-looking statements. Use of the words "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "plans," "potential," "projects," "should," "will," "would," "will likely continue," "will likely result" and similar expressions that contemplate future events may identify forward-looking statements.

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

Overview

We are a leading online provider of aftermarket auto parts, including collision parts, engine parts, and performance parts and accessories. Our user-friendly websites provide customers with a broad selection of 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 consumer websites are located at www.autopartswarehouse.com, www.carparts.com and www.jcwhitney.com and our corporate website is located at www.usautoparts.net.

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

1. Number of SKUs required to serve the market. The number of automotive SKUs has grown dramatically over the last several years. In today's market, unless the consumer is driving a high volume produced vehicle and needs a simple maintenance item, the part they need is not typically on the shelf at a brick-and-mortar store. We believe our user-friendly websites provide customers with a favorable alternative to the brick-and-mortar shopping experience by offering a comprehensive selection of over 1.5 million SKUs with detailed product descriptions, attributes and photographs combined with the flexibility of fulfilling orders using both drop-ship and stock-and-ship methods.
2. U.S. vehicle fleet expanding and aging. The average age of U.S. light vehicles, an indicator of auto parts demand, remained near record-highs at 11.7 years during 2018, according to the U.S. Auto Care Association, an industry association that expects the average age to rise even further during 2019. In addition, IHS, a market analytics firm, found that the total number of light vehicles in operation in the U.S. has increased to record levels, and should continue to rise through 2019. We believe an increasing vehicle base and rising average age of vehicles will have a positive impact on overall aftermarket parts demand because older vehicles generally require more repairs. In many cases we believe these older vehicles are driven by do-it-yourself

Table of Contents

("DIY") car owners who are more likely to handle any necessary repairs themselves rather than taking their car to the professional repair shop.

3. Growth of online sales. The U.S. Auto Care Association estimated that overall revenue from online sales of auto parts and accessories would reach approximately \$13.2 billion in 2018 and more than double by 2023. Improved product availability, lower prices and consumers' growing comfort with digital platforms are driving the shift to online sales. We believe that we are well positioned for the shift to online sales due to our history of being a leading source for aftermarket automotive parts through online marketplaces and our network of websites.

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

International Operations. In April 2007, we established offshore operations in the Philippines. Our offshore operations allow us to access a workforce with the necessary technical skills at a significantly lower cost than comparably experienced U.S.-based professionals. Our offshore operations are responsible for a majority of our website development, catalog management, and back office support. Our offshore operations also house our main call center. We had 701 employees in the Philippines as of December 29, 2018. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a more cost-effective manner than using U.S.-based resources.

AutoMD. In March of 2017, AutoMD, a majority owned subsidiary focused on auto repairs, filed for dissolution. The AutoMD operating segment has been classified as discontinued operations and its results of operations are reflected under loss from discontinued operations in our consolidated financial statements. The dissolution of AutoMD has a material impact on the Company's operations and financial results given it was previously reported under a separate operating segment.

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

	52 Weeks Ended December 29, 2018		52 Weeks Ended December 30, 2017	
Unique Visitors (millions)(1)	69.3		96.9	
E-commerce Orders (thousands)	1,760		1,892	
Online Marketplace Orders (thousands)	1,573		1,740	
Total Online Orders (thousands)	3,333		3,632	
E-commerce Average Order Value	\$ 98		\$ 101	
Online Marketplace Average Order Value	\$ 73		\$ 66	
Total Online Average Order Value	\$ 86		\$ 82	
Revenue Capture(1)	87.5	%	85.5	%
Conversion(1)	2.54	%	1.95	%

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

Unique Visitors: A unique visitor to a particular website represents a user with a distinct IP address that visits that particular website. We define the total number of unique visitors in a given month as the sum of unique visitors to each of our websites during that month. We measure unique visitors to understand the volume of traffic to our websites and to track the effectiveness of our online marketing efforts. The number of unique visitors has historically

varied based on a number of factors, including our marketing activities and seasonality. Included in the unique visitors are mobile device

25

Table of Contents

based customers, who are becoming an increasing part of our business. Shifting consumer behavior and technology enhancements indicates that customers are becoming more inclined to purchase auto parts through their mobile devices. User sophistication and technological advances have increased consumer expectations around the user experience on mobile devices, including speed of response, functionality, product availability, security, and ease of use. We believe enhancements to online solutions specifically catering to mobile based shopping can result in an increase in the number of orders and revenues. We believe an increase in unique visitors to our websites will result in an increase in the number of orders. We seek to increase the number of unique visitors to our websites by attracting repeat customers and improving search engine marketing and other internet marketing activities. During fiscal year 2018, our unique visitors decreased by 28.5% compared to the fiscal year 2017 primarily due to a shift in traffic from our e-commerce sites to online marketplaces, as described in further detail under “—Executive Summary” below.

Total Number of Orders: We monitor the total number of orders as an indicator of future revenue trends. During the fiscal year 2018, the total number of orders decreased by 8.2% compared to the fiscal year 2017, with e-commerce and online marketplace orders decreasing by 7.0% and 9.6%, respectively. We believe total number of orders declined primarily due to lower e-commerce traffic and a reduction in search presence on the platform of one of our marketplace partners, partially offset by higher conversion on our e-commerce sites.

Average Order Value: Average order value represents our net sales on a placed orders basis for a given period of time divided by the total number of orders recorded during the same period of time. During the fiscal year 2018, our average order value increased by 4.9% when compared to the fiscal year 2017 primarily driven by increases in online marketplaces order value. 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, mix changes between private label and branded, macro-economic conditions, and the competition online.

Revenue Capture: Revenue capture is the amount of actual dollars retained after taking into consideration returns, credit card declines and product fulfillment. During the fiscal year 2018, our revenue capture increased by 2.3% to 87.5% compared to 85.5% in fiscal year 2017, primarily due to various initiatives aimed at reducing returns and fulfillment expense.

Conversion: Conversion is the number of orders as a rate to the total number of unique visitors. This rate indicates how well we convert a visitor to a customer sales order. During fiscal year 2018, our conversion increased by 30.3% to 2.5% in fiscal year 2018 compared to 2.0% in fiscal year 2017 as a result of initiatives designed to improve the overall customer experience.

Executive Summary

For fiscal 2018, our continuing operations generated net sales of \$289,467, compared with \$303,366 for fiscal year 2017, representing a decrease of 4.6% compared to the prior year. Our continuing operations incurred a net loss for fiscal 2018 of \$4,889, compared to net income of \$24,574 for fiscal 2017. Our continuing operations generated Adjusted EBITDA, or net income before net interest expense, income tax provision, depreciation and amortization expense and amortization of intangible assets, share-based compensation expense, impairment loss and restructuring costs, costs related to our customs issues, proceeds from the sale of our AutoMD assets and employee transition costs ("Adjusted EBITDA"), of \$10,379 in fiscal 2018 compared to \$14,213 in fiscal 2017. Adjusted EBITDA, which is not a Generally Accepted Accounting Principle (GAAP) measure, is presented because management uses it as one measure of the Company's operating performance, as it assists in comparing the Company's operating performance on a consistent basis by removing the impact of stock compensation expense, as well as items that are not expected to be recurring. Internally, this non-GAAP measure is also used by management for planning purposes, including the preparation of internal budgets; for allocating resources to enhance financial performance; and for evaluating the

effectiveness of operational strategies. The Company also believes that such measure is used by rating agencies, securities analysts, investors and other parties in evaluating the Company. It should not be considered, however, as an alternative to operating income, or as an alternative to cash flows as a measure of the Company's overall liquidity, as presented in the Company's consolidated financial statements. Further, the Adjusted EBITDA measure shown may not be comparable to

Table of Contents

similarly titled measures used by other companies. Refer to the table presented below for reconciliation of net loss to Adjusted EBITDA.

Total revenues decreased in fiscal 2018 compared to fiscal 2017 primarily due to a decline in our online sales, partially offset by an increase in our offline sales. Our online sales, which include our e-commerce, online marketplace sales channels and online advertising, contributed 89.1% of total revenues, and our offline sales, which consist of our Kool-View® and wholesale operations, contributed 10.9% of total revenues. Our online sales for fiscal year 2018 decreased by \$16,294, or 5.9%, to \$258,014 primarily due to a decrease in total online orders of 8.2%, partially offset by an increase in average order value of 4.9%. The decrease in total orders was primarily attributable to a decrease in marketplace sales with one of our channel partners, as well as due to a decrease in e-commerce sales attributable to a reduction of traffic and lower in-stock rates resulting from our customs issues. Our offline sales increased by \$2,401, or 8.3%, to \$31,460 compared to the same period last year primarily due to increased sales of our Kool-View® product.

Like most e-commerce retailers, our success depends on our ability to attract online consumers to our websites and convert them into customers in a cost-effective manner. Historically, marketing through search engines provided the most efficient opportunity to reach millions of online auto part buyers. We are included in search results through paid search listings, where we purchase specific search terms that will result in the inclusion of our listing, and algorithmic searches that depend upon the searchable content on our websites. Algorithmic listings cannot be purchased and instead are determined and displayed solely by a set of formulas utilized by the search engine. We have had a history of success with our search engine marketing techniques, which gave our different websites preferred positions in search results. Search engines, like Google, revise their algorithms from time to time in an attempt to optimize their search results. During the last few years, Google has changed its search results ranking algorithm. In some cases our unique visitor count, and therefore our financial results, were negatively impacted by these changes. We continue to address the ongoing changes to the Google methodology, but during the fiscal year 2018, our unique visitor count decreased by 27.6 million, or 28.5%, to 69.3 million unique visitors compared to 96.9 million unique visitors in fiscal 2017 primarily due to a shift in traffic from our e-commerce sites to our online marketplaces. As in the past we expect Google will continue to make changes in their search engine algorithms to improve their user experience. As we are significantly dependent upon search engines for our website traffic, if we are unable to address these ongoing changes and attract unique visitors, our business and results of operations will be harmed.

Total expenses, which primarily consisted of cost of sales and operating costs, decreased in fiscal year 2018 compared to the same period in 2017. Components of our cost of sales and operating costs are described in further detail under — “Basis of Presentation” below.

We continue to pursue strategies to improve sales growth and gross profit while reducing operating costs as percent of sales:

- We believe we can return to positive e-commerce growth by continuing to focus on making the auto parts purchasing process as easy and seamless as possible. We plan to continue to provide unique catalog content and provide better content on our websites with the goal of improving our ranking on the search results.
- We continue to work to improve the website purchase experience for our customers by (1) helping our customers find the parts they want to buy by reducing failed searches and increasing user purchase confidence; (2) implementing guided navigation and custom buying experiences specific to strategic part names; (3) increasing order size across our sites through improved recommendation engines; (4) improving our site speed; and (5) creating a frictionless checkout experience for our customers. In addition, we intend to continue to improve our mobile enabled features to take advantage of shifting consumer behaviors. These efforts are intended to increase the conversion rate of our visitors to customers, the total number of orders and average order value, and the number of repeat purchases, as well as contribute to our revenue growth.

- We continue to work towards becoming one of the preferred low price options in the market for aftermarket auto parts and accessories. We also continue to offer lower prices by increasing foreign

27

Table of Contents

sourced private label products as they are generally less expensive and we believe provide better value for the consumer. We believe our product offering can improve the conversion rate of visitors to our websites, grow our revenues and improve our margins.

- We continue to increase product selection by being the first to market with many new SKUs. We currently have over 55,000 private label SKUs and over 1.5 million branded SKUs in our product selection. We will continue to seek to add new categories and expand our existing specialty categories. We believe continued product expansion will increase the total number of orders and contribute to our revenue growth. Additionally, we plan to continue to maintain certain in-stock inventory throughout the year to provide consistent service levels and improve customer experience.
- We continue to implement cost saving measures.

In January 2019, Lev Peker was appointed as Chief Executive Officer. Following his appointment, the Company is in the process of making additional investments in its marketing, user experience, and technology teams designed to improve organic and paid search, retention marketing and improvements to our technology infrastructure. We also plan to restructure the organization to focus on our most prominent e-commerce websites and provide users of our sites with the same or better experience than they would receive on the marketplace sites. We will therefore be placing a significant effort on restructuring our data and catalog methodologies to enhance the discovery of products and make our catalog a stronger competitive advantage on our e-commerce sites. We expect to start to receive some of the benefits from these investments towards the end of the year. We are also taking steps to offset some of the freight and competitive pressure which have impacted our gross margin, including developing exclusive private label parts not readily available to our competitors, delivering improved customer experience and making changes to our supply chain by getting closer to the customer to realize freight savings.

While we will shift resources away from the marketplace business, we will continue to be present in the marketplace platforms. Auto parts buyers are finding third-party online marketplaces to be a very attractive environment, for many reasons, the top five being: (1) the security of their personal information; (2) the ability to easily compare product offerings from multiple sellers; (3) transparency (consumers can leave positive or negative feedback about their experience); (4) favorable pricing; and (5) the availability of products not found in stock at brick-and-mortar stores. Successful selling in these third-party online marketplaces depends on product innovation, and strong relationships with suppliers, both of which we believe to be our core competencies.

Adjusted EBITDA, which is not a Generally Accepted Accounting Principle measure, is presented because management uses it as one measure of the Company's operating performance, as it assists in comparing the Company's operating performance on a consistent basis by removing the impact of stock compensation expense, as well as items that are not expected to be recurring. Internally, this non-GAAP measure is also used by management for planning purposes, including the preparation of internal budgets; for allocating resources to enhance financial performance; and for evaluating the effectiveness of operational strategies. The Company also believes that analysts and investors use Adjusted EBITDA as a supplemental measure to evaluate the ongoing operations of companies in our industry. It should not be considered, however, as an alternative to operating income, or as an alternative to cash flows as a measure of the Company's overall liquidity. Further, the Adjusted EBITDA measure shown may not be comparable to similarly titled

Table of Contents

measures used by other companies. The table below reconciles net income loss to Adjusted EBITDA for the periods presented (in thousands):

	Fifty-two weeks ended	
	December 29, 2018	December 30, 2017
(Loss) income from continuing operations	(4,889)	24,574
Depreciation & amortization	5,802	6,397
Amortization of intangible assets	185	319
Interest expense, net	1,595	1,647
Taxes	(329)	(21,540)
EBITDA	\$ 2,364	\$ 11,397
Stock comp expense	\$ 3,595	\$ 2,816
Employee transition costs	774	—
Customs Costs(1)	5,046	—
Proceeds from AutoMD sale	(1,400)	—
Adjusted EBITDA	\$ 10,379	\$ 14,213

(1) We incurred port and carrier fees and legal costs associated with our customs related issues. Refer to “Note 7 – Commitments and Contingencies” of our Notes to Consolidated Financial Statements for additional details.

Basis of Presentation

Net Sales. Online and offline sales represent two different sales channels for our products. We generate online net sales primarily through the sale of auto parts to individual consumers through our network of e-commerce websites, online marketplace sales channels and online advertising. E-commerce sales are derived from our network of websites, which we own and operate. E-commerce and online marketplace sales also include inbound telephone sales through our call center that supports these sales channels. Online marketplaces consist primarily of sales of our products on online marketplace websites, where we sell through storefronts that we maintain on third-party owned websites. We sell advertising and sponsorship positions on our e-commerce websites to highlight vendor brands and offer complementary products and services that benefit our customers. Advertising is targeted to specific sections of the websites and can also be targeted to specific users based on the vehicles they drive. Advertising partners primarily include part vendors, national automotive aftermarket brands and automobile manufacturers. Our offline sales channel represents our distribution of products directly to commercial customers by selling auto parts to collision repair shops. Our offline sales channel also includes both stock ship distribution as well as drop ship programs for automotive warehouse distributors and other online resellers. The product mix includes the majority of our private labeled stock ship items, which include the replacement collision parts and our Kool-View® mirror line. We also serve consumers by operating a retail outlet store in LaSalle, Illinois.

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

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

expense also includes depreciation and amortization expense and share-based compensation expense.

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

29

Table of Contents

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

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

Amortization of Intangible Assets. Amortization of intangibles consists of the amortization expense associated with our definite-lived intangible assets.

Impairment Loss. Impairment loss is recorded as a result of impairment testing performed for goodwill and indefinite-lived intangible assets in accordance with ASC 350 Intangibles – Goodwill and Other, and long-lived assets, including intangible assets subject to amortization, in accordance with ASC 360 Property, Plant and Equipment.

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

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

Discontinued Operations

The Company historically operated in two reportable operating segments, the core auto parts business ("Base USAP"), and an online automotive repair information source of which we were a majority stockholder ("AutoMD"). The criteria the Company used to identify operating segments were primarily the nature of the products we sell or services we provided and the consolidated operating results that were regularly reviewed by our chief operating decision maker to assess performance and make operating decisions. On March 6, 2017, AutoMD redeemed its stock from the minority stockholders and subsequently dissolved. The AutoMD operating segment has been classified as discontinued operations for all periods presented. See "Note 12 - Discontinued Operations" for further discussion.

Table of Contents

Results of Operations

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

	Fiscal Year Ended			
	December 29, 2018		December 30, 2017	
Net sales	100.0	%	100.0	%
Cost of sales	72.8		70.4	
Gross profit	27.2		29.6	
Operating expenses:				
Marketing	13.2		13.0	
General and administrative	6.9		5.8	
Fulfillment	7.4		7.6	
Technology	1.4		1.6	
Amortization of intangible assets	0.1		0.1	
Total operating expenses	28.9		28.1	
(Loss) income from operations	(1.7)		1.5	
Other income (expense):				
Other income, net	0.5		0.0	
Interest expense	(0.6)		(0.5)	
Total other expense, net	(0.1)		(0.5)	
Loss (income) from continuing operations before income taxes	(1.8)		1.0	
Income tax benefit	(0.1)		(7.1)	
(Loss) income from continuing operations	(1.7)	%	8.1	%

Fifty-Two Weeks Ended December 29, 2018 Compared to the Fifty-Two Weeks Ended December 30, 2017

Net Sales and Gross Margin

	Fiscal Year Ended		\$ Change	% Change	
	December 29, 2018	December 30, 2017			
	(in thousands)				
Net sales	\$ 289,467	\$ 303,366	\$ (13,899)	(4.6)	%
Cost of sales	210,746	213,706	(2,960)	(1.4)	%
Gross profit	\$ 78,721	\$ 89,660	\$ (10,939)	(12.2)	%
Gross margin	27.2 %	29.6 %		(2.4)	%

Net sales decreased \$13,899 for fiscal year 2018 compared to fiscal year 2017. Our net sales consisted of online sales, which include our e-commerce sites, online marketplace sales channels and online advertising, representing 89.1% of the total for fiscal year 2018 (compared to 90.4% in fiscal year 2017), and offline sales, representing 10.9% of the total for fiscal year 2018 (compared to 9.6% in fiscal year 2017). The net sales decrease was due to a decrease of \$16,294, or 5.9%, in online sales, partially offset by an increase of \$2,401, or 8.3%, in offline sales. Offline sales increased primarily due to increased Kool-View® sales. Our online sales decreased primarily due to a decrease in total online orders of 8.2%, partially offset by an increase in average order value of 4.9%. The decrease in total orders was

primarily attributable to a decrease in marketplace sales with one of our channel partners, as well as due to a decrease in e-commerce sales attributable to a reduction of traffic and lower in-stock rates resulting from our customs issues.

Gross profit decreased \$10,939, or 12.2%, in fiscal year 2018 compared to fiscal year 2017. Gross margin decreased 2.4% to 27.2% in fiscal year 2018 compared to 29.6% in fiscal year 2017. Gross margin decreased in fiscal year 2018 compared to fiscal year 2017 primarily due to a sales channel mix shift towards online marketplaces, as well as additional costs related to our customs issues and increased freight costs, partially offset by a favorable mix shift of private label sales compared to last year.

Table of Contents

Marketing Expense

	Fiscal Year Ended					
	December 29, 2018	December 30, 2017	\$ Change	% Change		
	(in thousands)					
Marketing expense	\$ 38,081	\$ 39,293	\$ (1,212)	(3.1)		
Percent of net sales	13.2	% 13.0	%	0.2		

Total marketing expense decreased \$1,212, or 3.1%, for fiscal year 2018 compared to fiscal year 2017. As a percent to net sales, total marketing expense was 13.2% for fiscal 2018 compared to 13.0% for fiscal year 2017. Online advertising expense, which includes catalog costs, was \$20,942, or 8.1%, of online sales for fiscal year 2018, compared to \$21,055, or 7.7%, of online sales for fiscal year 2017. Online advertising expense decreased primarily due to decreased e-commerce advertising, as well as the elimination of our catalog advertising program. Marketing expense, excluding online advertising, was \$17,181, or 5.9%, of net sales for fiscal year 2018, compared to \$18,238, or 6.0%, of net sales for fiscal year 2017. The decrease was primarily due to a decrease in labor costs.

General and Administrative Expense

	Fiscal Year Ended					
	December 29, 2018	December 30, 2017	\$ Change	% Change		
	(in thousands)					
General and administrative expense	\$ 19,963	\$ 17,612	\$ 2,351	13.3		
Percent of net sales	6.9	% 5.8	%	1		

General and administrative expense increased \$2,351, or 13.3%, for fiscal year 2018 compared to fiscal year 2017 primarily due to increased overhead costs, and legal costs associated with our customs issue. General and administrative expense increased as a percentage of net sales compared to 2017.

Fulfillment Expense

	Fiscal Year Ended					
	December 29, 2018	December 30, 2017	\$ Change	% Change		
	(in thousands)					
Fulfillment expense	\$ 21,310	\$ 23,090	\$ (1,780)	(7.7)		
Percent of net sales	7.4	% 7.6	%	(0)		

Fulfillment expense decreased \$1,780, or 7.7%, for fiscal year 2018 compared to fiscal year 2017 primarily due to a decrease in depreciation and amortization. Fulfillment expense decreased as a percentage of net sales compared to 2017.

Technology Expense

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

	Fiscal Year Ended				
	December 29, 2018	December 30, 2017	\$	Change	% Change
	(in thousands)				
Technology expense	\$ 4,188	\$ 4,711	\$	(523)	(11.1) %
Percent of net sales	1.4 %	1.6 %	%	(0.1)	%

Technology expense decreased \$523, or 11.1%, for fiscal year 2018 compared to fiscal year 2017 primarily due to decreased labor expenses. Technology expense decreased slightly as a percentage of net sales compared to 2017.

Table of Contents

Total Other Expense, Net

	Fiscal Year Ended				
	December 29, 2018	December 30, 2017	\$ Change	% Change	
	(in thousands)				
Other expense, net	\$ (211)	\$ (1,601)	\$ 1,390	(86.8)	%
Percent of net sales	(0.1) %	(0.5) %		0.5	

Total other expense, net decreased \$1,390, or 86.8%, for fiscal year 2018 compared to fiscal year 2017. Total other expense decreased during fiscal year 2018 compared to fiscal year 2017 primarily due to the sale of AutoMD assets. (See further detail in “Note 4 – Borrowings” of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report).

Income Tax Provision

	Fiscal Year Ended				
	December 29, 2018	December 30, 2017	\$ Change	% Change	
	(in thousands)				
Income tax benefit	\$ (329)	\$ (21,540)	\$ 21,211	(98.5)	%
Percent of net sales	(0.1) %	(7.1) %		7.0	%

The Company accounts for income taxes in accordance with ASC Topic 740 - Income Taxes (“ASC 740”). Under the provisions of ASC 740, management is required to evaluate whether a valuation allowance should be established against its deferred tax assets. As of the end of the second quarter of 2017, in part because in the period then ended the Company achieved three years of cumulative pre-tax income in the U.S. federal tax jurisdiction and positive earnings were projected to occur in the future due to improved operating performance as a result of our focus on expense controls and private label product sales, management determined that sufficient positive evidence existed to conclude that it was more likely than not that a portion of the deferred taxes in the amount of \$27,248 were realizable, and therefore, reduced the valuation allowance accordingly.

As of each reporting date, the Company’s management considers new evidence, both positive and negative, that could impact management’s view with regard to future realization of deferred tax assets. As of December 29, 2018, there was no material change in the evidence as it related to the amount of the Company’s deferred tax assets that were more likely than not to be realized in future years and so the Company continued to maintain a valuation allowance in the amount of \$5,816 against deferred tax assets that were not more likely than not of being recognized. As we continue to assess our operations, to the extent our results and expectations of core earnings continue to improve, we may release additional valuation reserves in the future. Conversely, to the extent that our results deteriorate, we may be required to reverse some, or even all, of the allowance released.

The Tax Cuts and Jobs Act was enacted on December 22, 2017 and reduced the U.S. federal corporate tax rate to 21 percent effective January 1, 2018. Consequently, we have recorded a decrease in our deferred tax assets, deferred tax liabilities and valuation allowance of \$13,630, \$1,459 and \$1,494, respectively, with a corresponding net adjustment to reduce deferred income tax benefit of \$10,677 for the year ended December 30, 2017.

Table of Contents

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

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Income tax at U.S. federal statutory rate	\$ (1,096)	\$ 1,032
Change in U.S. federal statutory rate	—	12,171
Tax attributes written off	522	1,110
Share-based compensation	727	1,027
State income tax, net of federal tax effect	(66)	231
Foreign tax	68	(77)
Other	9	38
Change in valuation allowance	(493)	(37,072)
Effective income tax benefit	\$ (329)	\$ (21,540)

As of December 29, 2018, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. At December 29, 2018, federal and state net operating loss (“NOL”) carryforwards were \$74,418 and \$72,152, respectively. Federal NOL carryforwards of \$2,106 were acquired in the acquisition of WAG which are subject to Internal Revenue Code section 382 and limited to an annual usage limitation of \$135. Federal NOL carryforwards begin to expire in 2029, while state NOL carryforwards begin to expire in 2019.

Liquidity and Capital Resources

Sources of Liquidity

During the fifty-two weeks ended December 29, 2018, we primarily funded our continuing operations with cash and cash equivalents generated from operations as well as through borrowing under our credit facility. We had cash and cash equivalents of \$2,031 as of December 29, 2018, representing a \$819 decrease from \$2,850 of cash and cash equivalents as of December 30, 2017. The cash decrease was primarily due to cash used in financing activities. Based on our current operating plan, we believe that our existing cash and cash equivalents, investments, cash flows from operations and available funds under our credit facility will be sufficient to finance our operations through at least the next twelve months (see “Debt and Available Borrowing Resources” and “Funding Requirements” below).

As of December 29, 2018, our credit facility provided for a revolving commitment of up to \$30,000 subject to a borrowing base derived from certain of our receivables, inventory and property and equipment. (see “Debt and Available Borrowing Resources” below).

Working Capital

As of December 29, 2018 and December 30, 2017, our working capital was \$10,466 and \$13,634, respectively. Our revolving loan does not require principal payments, however it is classified as current due to certain U.S. GAAP requirements (see “Debt and Available Borrowing Resources” below for further details). The historical seasonality in our business during the year can cause cash and cash equivalents, inventory and accounts payable to fluctuate, resulting in changes in our working capital.

Table of Contents

Cash Flows

The following table summarizes the key cash flow metrics from our consolidated statements of cash flows for fiscal year 2018, and 2017, respectively (in thousands):

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Net cash provided by operating activities	\$ 6,181	\$ 11,634
Net cash used in investing activities	(5,689)	(4,857)
Net cash used in financing activities	(1,283)	(10,565)
Effect of exchange rate changes on cash	(27)	(5)
Net change in cash and cash equivalents	\$ (819)	\$ (3,793)

Operating Activities

Cash provided by operating activities is primarily comprised of net income, adjusted for non-cash activities such as depreciation and amortization expense, amortization of intangible assets, impairment losses and share-based compensation expense. These non-cash adjustments represent charges reflected in net income and, therefore, to the extent that non-cash items increase or decrease our operating results, there will be no corresponding impact on our cash flows. Net income adjusted for non-cash adjustments to operating activities was \$4,267 (adjusted for non-cash charges primarily consisting of depreciation and amortization expense of \$5,802 and share-based compensation expense of \$3,595) for the period ended December 29, 2018 compared to \$12,130 (adjusted for non-cash charges primarily consisting of deferred income taxes of \$21,476 and depreciation and amortization expense of \$6,397) for the period ended December 30, 2017. After excluding the effects of the non-cash charges, the primary changes in cash flows relating to operating activities resulted from changes in operating assets and liabilities.

- Accounts receivable increased to \$3,727 at December 29, 2018 from \$2,470 at December 30, 2017, resulting in an increase in operating assets and reflecting a cash outflow of \$1,257 for the fiscal year ended December 29, 2018. Accounts receivable increased primarily due to increases in trade and credit card receivables due related to timing of collections during the year-end holiday season.
- Inventory decreased to \$49,626 at December 29, 2018 from \$54,231 at December 30, 2017, resulting in a decrease in operating assets and reflecting a cash inflow of \$4,605 for the fiscal year ended December 29, 2018.
- Accounts payable and accrued expenses increased to \$44,286 at December 29, 2018 compared to \$43,362 at December 30, 2017 resulting in an increase in operating liabilities and reflecting a cash inflow of \$924 for the fiscal year ended December 29, 2018. Accounts payable and accrued expenses increased primarily due to an increase in accrued expenses of \$2,884.
- Other current liabilities increased to \$2,918 resulting in an increase in operating liabilities and reflecting a cash inflow of \$461 for the fiscal year ended December 29, 2018. Other current liabilities increased primarily due to an increase in the sales returns accrual.

Investing Activities

For the fiscal years ended December 29, 2018 and December 30, 2017, net cash used in investing activities was primarily the result of increases in property and equipment (\$5,689, and \$4,896 respectively). Property and equipment is primarily internally developed software. Capitalized costs include amounts directly related to website and software development, primarily payroll and payroll related costs for employees and outside contractors who are directly associated with and devote time to the internal use software project.

Table of Contents

Financing Activities

For the fiscal year ended December 29, 2018, net cash used in financing activities was primarily due to payments made on our revolving loan payable. For the fiscal year ended December 30, 2017, net cash used in financing activities was primarily due to repurchases of outstanding shares of common stock, and payments made on our revolving loan payable. (see further discussion in “Debt and Available Borrowing Resources” below).

Debt and Available Borrowing Resources

Total debt (comprised of capital lease payable) was \$9,153 as of December 29, 2018 compared to \$9,752 as of December 30, 2017.

The Company maintains an asset-based revolving credit facility (“Credit Facility”) that provides for, among other things, a revolving commitment in an aggregate principal amount of up to \$30,000, which is subject to a borrowing base derived from certain receivables, inventory and property and equipment. At December 29, 2018, our outstanding revolving loan balance was \$0. The customary events of default under the Credit Facility (discussed below) include certain subjective acceleration clauses. Management has determined the likelihood of an acceleration is more than remote, considering the recurring losses experienced by the Company. As a result, any outstanding borrowings under the Credit Facility would be classified as a current liability.

Loans drawn under the credit facility bear interest at a per annum rate equal to either (a) LIBOR plus an applicable margin of 1.25%, or (b) a “base rate” subject to an increase or reduction by up to 0.25% per annum based on the Company’s fixed charge coverage ratio. At December 29, 2018, the Company’s LIBOR based interest rate was 3.81% (on \$0 principal) and the Company’s prime based rate was 5.25% (on \$0 principal). A commitment fee, based upon undrawn availability under the Credit Facility bearing interest at a rate of 0.25% per annum, is payable monthly. As of December 29, 2018, our outstanding letters of credit balance was \$14,714 of which \$11,433 was utilized and included in accounts payable on our consolidated balance sheet.

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

The Credit Agreement contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries, including, among other things, restrictions on indebtedness, liens, fundamental changes, investments, dispositions, prepayment of other indebtedness, mergers, and dividends and other distributions.

Events of default under the Credit Agreement include: failure to timely make payments due under the Credit Agreement; material misrepresentations or misstatements under the Credit Agreement and other related agreements; failure to comply with covenants under the Credit Agreement and other related agreements; certain defaults in respect of other material indebtedness; insolvency or other related events; certain defaulted judgments; certain ERISA-related

events; certain security interests or liens under the loan documents cease to be, or are challenged by the Company or any of its subsidiaries as not being, in full force and effect; any loan document or any material provision of the same ceases to be in full force and effect; and certain criminal indictments or convictions of any Loan Party. As of December 29, 2018, the Company was in compliance with all covenants under the Credit Agreement.

Table of Contents

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

As of December 29, 2018, the Company had total capital leases payable of \$9,153. The present value of the net minimum payments on capital leases as of December 29, 2018 is as follows:

Total minimum lease payments	\$ 15,317
Less amount representing interest	(6,164)
Present value of net minimum lease payments	9,153
Current portion of capital leases payable	594
Capital leases payable, net of current portion	\$ 8,559

See additional information in “Note 4 – Borrowings” of the Notes to Consolidated Financial Statements included in Part IV, Item 15 of this report.

Funding Requirements

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

Off-Balance Sheet Arrangements

We have no significant off-balance sheet arrangements.

Seasonality

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

operations during the reporting periods in any given year.

Inflation

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

37

Table of Contents

Recent Accounting Pronouncements

See “Note 1 – Summary of Significant Accounting Policies and Nature of Operations” of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report.

Critical Accounting Policies and Estimates

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

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

Revenue Recognition. We recognize revenue from product sales and shipping revenues, net of promotional discounts and return allowances, when the following five revenue recognition criteria are met: a contract has been identified, separate performance obligations are identified, the transaction price is determined, the transaction price is allocated to separate performance obligations and revenue is recognized upon satisfying each performance obligation. The Company transfers the risk of loss or damage upon shipment, therefore, revenue from product sales is recognized when it is shipped to the customer. Return allowances, which reduce product revenue by the Company’s best estimate of expected product returns, are estimated using historical experience.

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

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

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

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

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

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606), which was further updated in March, April, May and December 2016. We adopted this ASU on December 31, 2017 with a cumulative adjustment to increase retained earnings rather than retrospectively adjusting prior periods. The cumulative

Table of Contents

adjustment and related costs was \$340, and was due to no longer recording a synthetic shipping lag adjustment. In the current year we began to recognize revenue upon shipment. Therefore, we do not anticipate a significant effect on future revenue amounts.

Inventory. Inventory consists of finished goods available-for-sale. We purchase inventory from suppliers both domestically and internationally, primarily in Taiwan and China. We believe that our products are generally available from more than one supplier, and we maintain multiple sources for many of our products, both internationally and domestically. We offer a broad line of auto parts for automobiles, trucks, motorcycles and recreational vehicles from model years 1965 to 2018. Because of the continued demand for our products, we primarily purchase products in bulk quantities to take advantage of quantity discounts and to ensure inventory availability.

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

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

Income Taxes. The Company accounts for income taxes in accordance with ASC Topic 740 - Income Taxes (“ASC 740”). Under ASC 740, deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. When appropriate, a valuation reserve is established to reduce deferred tax assets, which include tax credits and loss carry forwards, to the amount that is more likely than not to be realized. The ability to realize deferred tax assets depends on the ability to generate sufficient taxable income within the carryforward periods provided for in the tax law for each applicable tax jurisdiction. We consider the following possible sources of taxable income when assessing the realization of our deferred tax assets:

- Future reversals of existing taxable temporary differences;
- Future taxable income exclusive of reversing temporary differences and carryforwards;
- Tax-planning strategies.

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

Concluding that a valuation allowance is not required is difficult when there is significant negative evidence that is objective and verifiable, such as cumulative losses in recent years. We utilized a three-year analysis of actual results as

Table of Contents

the primary measure of cumulative losses in recent years. In addition, the near- and medium-term financial outlook is considered when assessing the need for a valuation allowance.

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

We utilize a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. The Company's policy is to record interest and penalties as income tax expense.

Share-Based Compensation. We account for share-based compensation in accordance with ASC Topic 718 Compensation – Stock Compensation (“ASC 718”). ASC 718 requires that all share-based compensation to employees, including grants of employee stock options, be recognized in our financial statements based on their respective grant date fair values. Under this standard, the fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. We currently use the Black-Scholes option pricing model to estimate the fair value of our share-based payment awards. The Black-Scholes valuation models require extensive use of accounting judgment and financial estimates, including estimates of the expected term participants will retain their vested stock options before exercising them, the estimated volatility of our common stock price over the expected term and the number of options that will be forfeited prior to the completion of their vesting requirements. Application of alternative assumptions could produce significantly different estimates of the fair value of share-based compensation and, consequently, the related amount of share-based compensation expense recognized in the Consolidated Statements of Comprehensive Operations could have been significantly different than the amounts recorded.

The Company has incorporated its own historical volatility into the grant-date fair value calculations. The Company's historical volatility was not materially different than the estimates applied to past award fair value calculations. The expected term of an award is based on combining historical exercise data with expected weighted time outstanding. Expected weighted time outstanding is calculated by assuming the settlement of outstanding awards is at the midpoint between the remaining weighted average vesting date and the expiration date.

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company as defined by Rule 12b-2 of the Exchange Act, we are not required to provide the information under this item.

40

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed with the SEC under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), is recorded, processed, summarized and reported within the specified time periods, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 29, 2018 pursuant to Rule 13a-15 and 15d-15 of the Exchange Act. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective to meet the objectives for which they were designed and operated at the reasonable assurance level.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). We assessed the effectiveness of our internal control over financial reporting as of December 29, 2018, based on the “Internal Control — Integrated Framework (2013)” issued by the Committee of Sponsoring Organizations of the Treadway Commission. This assessment was conducted utilizing our documentation of policies and procedures, risk control matrices, gap analysis, key process walk-throughs and management’s knowledge of and interaction with its controls and testing of our key controls.

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

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Based on such assessment and criteria, management has concluded that the internal controls over financial reporting were not effective as of December 29, 2018.

As of December 29, 2018, we had identified a matter that constituted a material weakness in our internal controls over financial reporting, related to review over the accounting for significant and unusual transactions. As a result, abnormal in-bound costs related to inventory affected by our customs issues were improperly amortized over the life of the effected inventory, rather than being expensed as period charges. In addition, certain impacts of the Tax Cuts

and Jobs Act related to interest deduction limitations were incorrectly calculated in our initial tax provision. We are taking steps to correct this material weakness, including enhancing our policies, procedures and controls around having any significant and unusual items immediately brought to the attention of the accounting team to have them properly researched and have the appropriate accounting treatment applied. As it relates to this issue, we have performed

41

Table of Contents

additional analyses and other procedures to ensure that our consolidated financial statements contained in this Annual Report were prepared in accordance with GAAP and applicable SEC regulations.

Changes in Internal Control Over Financial Reporting

The Company monitors and evaluates on an ongoing basis its internal control over financial reporting in order to improve its overall effectiveness. In the course of these evaluations, the Company modifies and refines its internal processes as conditions warrant. As required by Rule 13a-15(d), the Company's management, including the Chief Executive Officer and the Chief Financial Officer, also conducted an evaluation of the Company's internal control over financial reporting to determine whether any changes occurred during the quarter ended December 29, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the period covered by this report however, based upon the aforementioned material weakness, we will be making the changes described above to enhance our internal controls.

ITEM 9B. OTHER INFORMATION

None.

42

Table of Contents

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

- (a) Identification of Directors. The information under the caption “Election of Directors,” appearing in the Proxy Statement (“Proxy Statement”), is hereby incorporated by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.
- (b) Identification of Executive Officers and Certain Significant Employees. The information under the caption “Executive Compensation and Other Information—Executive Officers,” appearing in the Proxy Statement, is hereby incorporated by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.
- (c) Compliance with Section 16(a) of the Exchange Act. The information under the caption “Section 16(a) Beneficial Ownership Reporting Compliance,” appearing in the Proxy Statement, is hereby incorporated by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.
- (d) Code of Ethics. The information under the caption “Corporate Governance – Code of Ethics and Business Conduct,” appearing in the Proxy Statement, is hereby incorporated by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.
- (e) Board Committees. The information under the caption “Corporate Governance — Board Committees and Meetings,” appearing in the Proxy Statement, is hereby incorporated by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.

ITEM 11. EXECUTIVE COMPENSATION

The information under the caption “Executive Compensation and Other Information”, appearing in the Proxy Statement, is incorporated herein by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.

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

The information under the captions “Securities Authorized for Issuance Under Equity Compensation Plans” and “Ownership of Securities by Certain Beneficial Owners and Management,” appearing in the Proxy Statement, is incorporated herein by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.

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

The information under the captions “Corporate Governance — Director Independence” and “Certain Relationships and Related Transactions,” appearing in the Proxy Statement, is incorporated herein by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information under the caption “Fees Paid to Independent Registered Public Accounting Firm,” appearing in the Proxy Statement, is incorporated herein by reference. The Proxy Statement will be filed with the SEC within 120 days from the end of fiscal year 2018.

Table of Contents

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

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

	Page
<u>Report of RSM US LLP, independent registered public accounting firm</u>	1
<u>Consolidated Balance Sheets as of December 29, 2018 and December 30, 2017</u>	2
<u>Consolidated Statements of Operations and Comprehensive Operations for each of the two years in the period ended December 29, 2018</u>	3
<u>Consolidated Statements of Stockholders' Equity for each of the two years in the period ended December 29, 2018</u>	4
<u>Consolidated Statements of Cash Flows for each of the two years in the period ended December 29, 2018</u>	5
<u>Notes to Consolidated Financial Statements</u>	6

(2) Financial Statement Schedules.

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

(3) Exhibits.

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

44

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
2.1	<u>Stock Purchase Agreement executed August 2, 2010 among the Acquisition Sub, WAG, Riverside and the other stockholders of WAG (incorporated by reference to Exhibit 10.57 to the Company's Current Report on Form 8 K filed with the Securities and Exchange Commission on August 4, 2010)</u>
3.1	<u>Second Amended and Restated Certificate of Incorporation of U.S. Auto Parts Network, Inc. as filed with the Delaware Secretary of State on February 14, 2007 (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10 K filed with the Securities and Exchange Commission on April 2, 2007)</u>
3.2	<u>Amended and Restated Bylaws of U.S. Auto Parts Network, Inc. (incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10 K filed with the Securities and Exchange Commission on April 2, 2007)</u>
3.3	<u>Certificate of Designation, Preferences and Rights of the Series A Convertible Preferred Stock of U.S. Auto Parts Network, Inc. (incorporated by reference to the Current Report on Form 8 K filed on March 25, 2013)</u>
3.4	<u>Amendment to Amended and Restated Bylaws of U.S. Auto Parts Network, Inc. (incorporated by reference to Exhibit 3.4 to the Annual Report on Form 10 K file with the Securities and Exchange Commission on March 11, 2016)</u>
4.1*	<u>Specimen common stock certificate</u>
10.1+*	<u>U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan</u>
10.2+*	<u>Form of Stock Option Agreement under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.</u>
10.3+*	<u>Form of Notice of Grant of Stock Option under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.</u>
10.4+*	<u>Form of Acceleration Addendum to Stock Option Agreement under the U.S. Auto Parts Network, Inc. 2006 Equity Incentive Plan.</u>
10.5+*	<u>U.S. Auto Parts Network, Inc. 2007 Omnibus Plan and Form of Award Agreements</u>
10.6+	<u>2018 Independent Director Compensation Plan (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10 Q filed with the Securities and Exchange Commission on August 9, 2018)</u>
10.7+	<u>Form of Indemnification Agreement for Officers and Directors (incorporated by reference to Exhibit 10.7 to the Annual Report on Form 10 K filed with the Securities and Exchange Commission on March 11, 2016)</u>
10.8+	

Employment Agreement dated March 23, 2015 between U.S. Auto Parts Network, Inc. and Neil Watanabe (incorporated by reference to Exhibit 99.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on March 24, 2015).

10.9+ Amended Employment Agreement dated June 14, 2018 between the Company and David Eisler (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10 Q filed with the Securities and Exchange Commission on August 9, 2018)

10.10+ Employment Agreement dated November 27, 2018 between the Company and Lev Peker (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on November 28, 2018)

10.11 Board Candidate Agreement dated May 31, 2018 by and among the Company, Mehran Nia, and the Nia Living Trust Established September 2, 2004 (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on June 1, 2018)

Table of Contents

Exhibit No.	Description
10.12	<u>Letter Agreement, dated May 31, 2018, by and U.S. Auto Parts Network, Inc., Mina Khazani, and the Mina Khazani Living Trust, Dated May 30, 2007 (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on June 1, 2018)</u>
10.13+	<u>Transition Consulting Services Agreement dated March 30, 2017 between the Company and Shane Evangelist (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on March 31, 2017)</u>
10.14+	<u>Employment Agreement dated March 30, 2017, between the Company and Aaron Coleman (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on March 31, 2017)</u>
10.15+	<u>Form of Notice of Grant of Restricted Stock Units to Directors under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10 Q filed with the Securities and Exchange Commission on August 9, 2018)</u>
10.16	<u>Contract of Lease dated January 7, 2010 by and between U.S. Autoparts Network Philippines Corporation and Robinsons Land Corporation (incorporated by reference to Exhibit 10.56 to the Annual Report on Form 10 K filed with the Securities and Exchange Commission on March 15, 2010)</u>
10.17	<u>Agreement of Sublease dated September 22, 2011 by and between the Company and Timec Company Inc. (incorporated by reference to Exhibit 10.61 to the Company's Quarterly Report on Form 10 Q filed with the Securities Exchange and Commission on November 9, 2011)</u>
10.18	<u>First Amendment to Agreement of Sublease, dated June 1, 2016, between the Company and Broadpectrum Downstream Services, Inc. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on June 2, 2016)</u>
10.19+	<u>U.S. Auto Parts Network Inc. Director Payment Election Plan (incorporated by reference to Exhibit 10.68 to the Company's Quarterly Report on Form 10 Q filed with the Securities and Exchange Commission on November 9, 2011)</u>
10.20	<u>Credit Agreement, dated April 26, 2012, by and between U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JP Morgan Chase Bank, N.A. (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on April 30, 2012)</u>
10.21	<u>First Amended Credit Agreement, effective as of March 12, 2013, by and between U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 10.78 to the Annual Report on Form 10 K for the fiscal year ended December 29, 2012 filed with the Securities Exchange Commission on March 25, 2013)</u>
10.22	<u>Second Amended Credit Agreement, effective as of March 25, 2013, by and between U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A. (incorporated by reference to exhibit 10.2 to the Current Report on Form 8 k filed with the Securities and Exchange Commission on March 25, 2013)</u>

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

- 10.23 Purchase and Sale Agreement dated April 17, 2013 by and among Whitney Automotive Group, Inc. and STORE Capital Acquisitions, LLC (incorporated by reference to the Current Report on Form 8 K filed on April 23, 2013)
- 10.24 Lease Agreement dated April 17, 2013 by and among U.S. Auto Parts Network, Inc. and STORE Master Funding III, LLC (incorporated by reference to the Current Report on Form 8 K filed on April 23, 2013)
- 10.25+ Form of Stock Unit Award Agreement (incorporated by reference to Exhibit 99.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on February 18, 2014)
- 10.26+ Form of Stock Unit Award Agreement under the U.S. Auto Parts Network, Inc. 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 99.3 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on February 18, 2014)

Table of Contents

Exhibit No.	Description
10.27	<u>Third Amendment to Credit Agreement dated as of August 2, 2013 by and between U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A. (incorporated by reference to the Quarterly Report on Form 10-Q for the quarterly period ended June 29, 2013)</u>
10.28	<u>Fourth Amendment to Credit Agreement dated August 4, 2014 by and between U.S. Auto Parts Network, Inc., certain of its wholly-owned domestic subsidiaries and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 5, 2014)</u>
10.29	<u>Fifth Amendment to Credit Agreement and First Amendment to Pledge and Security Agreement, dated October 8, 2014, by and among U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A (incorporated by reference to the Current Report on Form 8-K filed on October 9, 2014)</u>
10.30	<u>Sixth Amendment to Credit Agreement and First Amendment to Pledge and Security Agreement, dated January 2, 2015, by and among U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A (incorporated by reference to the Current Report on Form 8-K filed on January 5, 2015)</u>
10.31	<u>Seventh Amendment to Credit Agreement and Second Amendment to Pledge and Security Agreement, dated March 24, 2015, by and among U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed on May 13, 2015)</u>
10.32	<u>Eighth Amendment to Credit Agreement and Third Amendment to Pledge and Security Agreement, dated February 5, 2016, by and among U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A (incorporated by reference to Exhibit 10.38 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 11, 2016)</u>
10.33	<u>Ninth Amendment to Credit Agreement, dated May 6, 2016, by and among U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed on May 10, 2016)</u>
10.34	<u>Tenth Amendment to Credit Agreement and Fourth Amendment to Pledge and Security Agreement, dated November 15, 2016, by and among U.S. Auto Parts Network, Inc., certain of its domestic subsidiaries and JPMorgan Chase Bank, N.A (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on November 15, 2016)</u>
10.35	<u>Form of Performance Restricted Stock Unit Award Agreement under the U.S. Auto Parts Network, Inc. 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on January 26, 2016)</u>
10.36	<u>Form of 2018 Performance Restricted Stock Unit Award Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on January 11, 2018)</u>
10.37	

Form of 2018 Performance Cash Bonus Award Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 11, 2018)

10.38 Form of 2018 Restricted Stock Unit Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 11, 2018)

10.39 Deed of Lease dated February 4, 2016 by and between U.S. Auto Parts Network, Inc. and Liberty Property Limited Partnership (incorporated by reference to Exhibit 10.43 to the Annual Report on Form 10 K filed with the Securities and Exchange Commission on March 11, 2016)

Table of Contents

Exhibit No.	Description
10.40	<u>U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on June 2, 2016)</u>
10.41	<u>Form of Employee Option Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on June 2, 2016)</u>
10.42	<u>Form of Director Option Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.4 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on June 2, 2016)</u>
10.43	<u>Form of Restricted Stock Unit Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.5 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on June 2, 2016)</u>
10.44	<u>Form of Performance Restricted Stock Unit Award Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 26, 2017)</u>
10.45	<u>Form of Performance Cash Bonus Award Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 26, 2017)</u>
10.46	<u>Form of Director and Section 16 Officer Restricted Stock Unit Agreement under the U.S. Auto Parts Network, Inc. 2016 Equity Incentive Plan (incorporated by reference to Exhibit 10.4 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 26, 2017)</u>
10.47	<u>Redemption Agreement, dated January 26, 2017 by and among AutoMD, Inc., Federal-Mogul Motorparts Corporation, and Muzzy-Lyon Auto Parts, Inc. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 30, 2017)</u>
10.48	<u>Redemption Agreement, dated January 26, 2017 by and among AutoMD, Inc. and Manheim Investments, Inc. (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 30, 2017)</u>
10.49	<u>Release Agreement, dated January 26, 2017 by and among AutoMD, Inc., U.S. Auto Parts Network, Inc., Muzzy-Lyon Auto Parts, Inc., Federal-Mogul Motorparts Corporation, Manheim Investments, Inc., Oak Investment Partners XI, L.P. and the Sol Khazani Living Trust (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 30, 2017)</u>
10.50	<u>Deferred Compensation Plan (incorporated by reference to Exhibit 10.54 to the Annual Report on Form 10 K filed with the Securities and Exchange Commission on March 7, 2017)</u>
10.51	

Dissolution Agreement, dated March 6, 2017, by and among AutoMD, Inc., Oak Investment Partners XI, L.P. and the Sol Khazani Living Trust. (incorporated by reference to Exhibit 10.55 to the Annual Report on Form 10 K filed with the Securities and Exchange Commission on March 7, 2017)

10.52+ Separation Agreement and Release of Claims, dated October 5, 2018, by and between the Company and Aaron Coleman (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on October 10, 2018)

10.53+ Separation Agreement and Release of Claims, dated December 11, 2018, by and between the Company and David Eisler (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on December 11, 2018)

10.54 Board Candidate Agreement dated January 18, 2019 by and among the Company, David Kanen, Kanen Wealth Management LLC, and Philotimo Fund, LP. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 23, 2019)

Table of Contents

Exhibit No.	Description
10.55	<u>Amendment to Board Candidate Agreement dated January 17, 2019 by and among the Company, Mehran Nia, and the Nia Living Trust Established September 2, 2004. (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 23, 2019)</u>
10.56+	<u>Separation Agreement and Release of Claims, dated January 23, 2019, by and between the Company and Roger Hoffmann. (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 23, 2019)</u>
10.57+	<u>Separation Agreement dated January 23, 2019, by and between U.S. Auto Parts Network (Philippines) Corp. and Roger Hoffmann. (incorporated by reference to Exhibit 10.4 to the Current Report on Form 8 K filed with the Securities and Exchange Commission on January 23, 2019)</u>
21.1	<u>Subsidiaries of U.S. Auto Parts Network, Inc.</u>
23.1	<u>Consent of Independent Registered Public Accounting Firm</u>
31.1	<u>Certification of the Principal Executive Officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended</u>
31.2	<u>Certification of the Principal Financial Officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended</u>
32.1	<u>Certification of the Chief Executive Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certification of the Chief Financial Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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

+Indicates a management contract or compensatory plan or arrangement.

49

Table of Contents

SIGNATURES

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

Date: March 12, 2019 U.S. AUTO PARTS NETWORK, INC.

By: /s/ Lev Peker
 Lev Peker
 Chief Executive Officer

POWER OF ATTORNEY

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

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

Signature	Title	Date
/s/ Lev Peker Lev Peker	Chief Executive Officer and Director (principal executive officer)	March 12, 2019
/s/ Neil Watanabe Neil Watanabe	Chief Financial Officer (principal financial and accounting officer)	March 12, 2019
/s/ Warren B. Phelps III Warren B. Phelps III	Chairman of the Board	March 12, 2019
/s/ Joshua L. Berman Joshua L. Berman	Director	March 12, 2019
/s/ Jay K. Greyson Jay K. Greyson	Director	March 12, 2019
/s/ David Kanen David Kanen	Director	March 12, 2019
/s/ Sol Khazani Sol Khazani	Director	March 12, 2019
/s/ Mehran Nia Mehran Nia	Director	March 12, 2019
/s/ Barbara Palmer Barbara Palmer	Director	March 12, 2019

/s/ Bradley E. Wilson
Bradley E. Wilson

Director

March 12, 2019

Table of Contents

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

<u>Report of RSM US LLP, independent registered public accounting firm</u>	F- 1
<u>Consolidated Balance Sheets as of December 29, 2018 and December 30, 2017</u>	F- 2
<u>Consolidated Statements of Operations and Comprehensive Operations for each of the two years in the period ended December 29, 2018</u>	F- 3
<u>Consolidated Statements of Stockholders' Equity for each of the two years in the period ended December 29, 2018</u>	F- 4
<u>Consolidated Statements of Cash Flows for each of the two years in the period ended December 29, 2018</u>	F- 5
<u>Notes to Consolidated Financial Statements</u>	F- 6

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

U.S. Auto Parts Network, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of U.S. Auto Parts Network, Inc. and subsidiaries (the Company) as of December 29, 2018, and December 30, 2017, the related consolidated statements of operations and comprehensive operations, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 29, 2018, and December 30, 2017, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2015.

/s/ RSM US LLP

Los Angeles, CA

March 12, 2019

F-1

Table of ContentsU.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Par and Per Share Liquidation Value)

	December 29, 2018	December 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,031	\$ 2,850
Short-term investments	1	9
Accounts receivable, net	3,727	2,470
Inventory	49,626	54,231
Other current assets	3,400	2,972
Total current assets	58,785	62,532
Deferred income taxes	21,833	21,476
Property and equipment, net	15,184	15,085
Other non-current assets	2,163	1,605
Total assets	\$ 97,965	\$ 100,698
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 34,039	\$ 35,999
Accrued expenses	10,247	7,363
Current portion of capital leases payable	594	579
Customer deposits	521	2,500
Other current liabilities	2,918	2,457
Total current liabilities	48,319	48,898
Capital leases payable, net of current portion	8,559	9,173
Other non-current liabilities	2,265	2,266
Total liabilities	59,143	60,337
Commitments and contingencies		
Stockholders' equity:		
Series A convertible preferred stock, \$0.001 par value; \$1.45 per share liquidation value or aggregate of \$6,017; 4,150 shares authorized; 2,771 shares issued and outstanding at both December 29, 2018 and December 30, 2017	3	3
Common stock, \$0.001 par value; 100,000 shares authorized; 34,992 and 34,666 shares issued and outstanding at December 29, 2018 and December 30, 2017 (of which 2,525 are treasury stock)	38	37
Treasury stock	(7,146)	(7,146)
Additional paid-in capital	183,139	179,906
Accumulated other comprehensive income	579	557
Accumulated deficit	(137,791)	(132,996)
Total stockholders' equity	38,822	40,361
Total liabilities and stockholders' equity	\$ 97,965	\$ 100,698

See accompanying notes to consolidated financial statements.

Table of ContentsU.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE OPERATIONS

(In Thousands, Except Per Share Data)

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Net sales	\$ 289,467	\$ 303,366
Cost of sales (1)	210,746	213,706
Gross profit	78,721	89,660
Operating expenses:		
Marketing	38,081	39,293
General and administrative	19,963	17,612
Fulfillment	21,310	23,090
Technology	4,188	4,711
Amortization of intangible assets	185	319
Total operating expenses	83,727	85,025
(Loss) income from operations	(5,006)	4,635
Other income (expense):		
Other, net	1,387	54
Interest expense	(1,598)	(1,655)
Total other expense, net	(211)	(1,601)
Income from continuing operations before income taxes	(5,217)	3,034
Income tax benefit	(329)	(21,540)
(Loss) income from continuing operations	(4,889)	24,574
Discontinued operations (2)		
Loss from operations and disposal of discontinued AutoMD operations	—	(558)
Income tax provision	—	1
Loss on discontinued operations	—	(559)
Net (loss) income	(4,889)	24,015
Other comprehensive income:		
Foreign currency translation adjustments	22	(18)
Actuarial gain (loss) on defined benefit plan	—	19
Unrealized loss on investments	—	(1)
Total other comprehensive income	22	—
Comprehensive (loss) income	\$ (4,867)	\$ 24,015
(Loss) income from continuing operations per share:		
Basic (loss) income from continuing operations per share	\$ (0.14)	\$ 0.69
Diluted (loss) income from continuing operations per share	(0.14)	0.62
Weighted average common shares outstanding:		
Shares used in computation of basic income from continuing operations per share	34,941	35,192
Shares used in computation of diluted income from continuing operations per share	34,941	39,634

(1) Excludes depreciation and amortization expense which is included in marketing, general and administrative and fulfillment expense as described in “Note 1 – Summary of Significant Accounting Policies and Nature of Operations”.

(2)

During March 2017, AutoMD filed for dissolution and the AutoMD operating segment has been classified as discontinued operations.

See accompanying notes to consolidated financial statements.

F-3

Table of ContentsU.S AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands)

	Preferred Shares	Stock Amount	Common Shares	Stock Amount	Additional Paid-in- Capital	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity	Noncontrol- ling Interest
Currently										
January 1, 2016	4,150	4	34,623	35	180,402	(1,376)	557	(156,769)	22,853	469
Issuance of	—	—	—	—	—	—	—	24,015	24,015	—
Interest	—	—	—	—	(2,017)	—	—	—	(2,017)	(469)
Shares	—	—	1,074	1	258	—	—	—	259	—
in with	—	—	592	1	—	—	—	—	1	—
Shares	—	—	(220)	—	(755)	—	—	—	(755)	—
in with	—	—	(705)	(1)	(889)	—	—	—	(890)	—
Block	—	—	3	—	9	—	—	—	9	—
g	—	—	—	—	2,898	—	—	—	2,898	—
x	—	—	—	—	—	—	—	(189)	(189)	—
on	(1,379)	(1)	1,379	1	—	—	—	—	—	—
x	—	—	(2,080)	—	—	(5,770)	—	(53)	(5,823)	—
s on	—	—	—	—	—	—	19	—	19	—
ncised	—	—	—	—	—	—	—	—	—	—
shares	—	—	—	—	—	—	(1)	—	(1)	—
in with	—	—	—	—	—	—	(18)	—	(18)	—
on	2,771	3	34,666	37	179,906	(7,146)	557	(132,996)	40,361	—

ported										
0, 2017										
w										
adoption	—	—	—	—	—	—	—	255	255	—
currently										
0, 2017	2,771	3	34,666	37	179,906	(7,146)	557	(132,741)	40,616	—
	—	—	—	—	—	—	—	(4,889)	(4,889)	—
of										
erest	—	—	—	—	—	—	—	—	—	—
shares										
n with										
	—	—	6	—	6	—	—	—	6	—
shares										
n with										
ock										
g	—	—	479	1	—	—	—	—	1	—
x										
on										
	—	—	(166)	—	(430)	—	—	—	(430)	—
shares										
n with										
	—	—	7	—	14	—	—	—	14	—
n										
nd on										
ock	—	—	—	—	3,643	—	—	—	3,643	—
anges in										
encies	—	—	—	—	—	—	22	—	22	—
9, 2018	2,771	\$ 3	34,992	\$ 38	\$ 183,139	\$ (7,146)	\$ 579	\$ (137,791)	\$ 38,822	\$ —

See accompanying notes to consolidated financial statements.

Table of ContentsU.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Operating activities		
Net (loss) income	\$ (4,889)	\$ 24,015
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	5,802	6,397
Amortization of intangible assets	185	319
Deferred income taxes	(446)	(21,476)
Share-based compensation expense	3,595	2,842
Stock awards issued for non-employee director service	14	9
Amortization of deferred financing costs	4	32
Gain (loss) from disposition of assets	1	(8)
Changes in operating assets and liabilities:		
Accounts receivable	(1,257)	796
Inventory	4,605	(3,327)
Other current assets	(1,326)	(292)
Other non-current assets	149	40
Accounts payable and accrued expenses	742	2,725
Other current liabilities	(1,135)	(712)
Other non-current liabilities	136	274
Net cash provided by operating activities	6,181	11,634
Investing activities		
Additions to property and equipment	(5,689)	(4,896)
Proceeds from sale of property and equipment	1	39
Net cash used in investing activities	(5,689)	(4,857)
Financing activities		
Borrowings from revolving loan payable	3,316	3,835
Payments made on revolving loan payable	(3,316)	(3,835)
Minority shareholder redemption	—	(2,486)
Payments on capital leases	(598)	(561)
Treasury stock repurchases	—	(5,823)
Statutory tax withholding payment for share-based compensation	(430)	(1,644)
Proceeds from exercise of stock options	6	258
Payment of liabilities related to financing activities	(100)	(100)
Preferred stock dividends paid	(161)	(209)
Net cash used in financing activities	(1,283)	(10,565)
Effect of exchange rate changes on cash	(27)	(5)
Net change in cash and cash equivalents	(819)	(3,793)
Cash and cash equivalents, beginning of period	2,850	6,643
Cash and cash equivalents, end of period	\$ 2,031	\$ 2,850
Supplemental disclosure of non-cash investing and financing activities:		
Accrued asset purchases	\$ 1,008	\$ 831

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

Supplemental disclosure of cash flow information:

Cash paid during the period for income taxes	\$ 81	\$ 78
Cash paid during the period for interest	1,606	1,536

See accompanying notes to consolidated financial statements.

F-5

Table of Contents

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

(In Thousands, Except Per Share Data)

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

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

The Company’s products consist of collision parts serving the body repair market, engine parts to serve the replacement parts market, and performance parts and accessories. The collision parts category is primarily comprised of body parts for the exterior of an automobile. Our parts in this category are typically replacement parts for original body parts that have been damaged as a result of a collision or through general wear and tear. The majority of these products are sold through our websites. In addition, we sell an extensive line of mirror products, including our own private-label brand called Kool-Vue®, which are marketed and sold as aftermarket replacement parts and as upgrades to existing parts. The engine parts category is comprised of engine components and other mechanical and electrical parts including our private label brand of catalytic converters called Evan Fischer®. 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 has employees located in both the United States and the Philippines.

Fiscal Year

The Company’s fiscal year is based on a 52/53 week fiscal year ending on the Saturday closest to December 31. The fiscal years ended December 29, 2018 (fiscal year 2018) and December 30, 2017 (fiscal year 2017) are both 52 week periods.

Principles of Consolidation

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

Basis of Presentation

In fiscal year 2018, the Company incurred a net loss of \$4,889, compared to net income of \$24,015 in fiscal year 2017. Based on our current operating plan, we believe that our existing cash, cash equivalents, short-term investments, cash flows from operations and available debt financing will be sufficient to finance our operational cash needs through at least the next twelve months. Should the Company's operating results not meet expectations in 2019, it could negatively impact our liquidity as we may not be able to provide positive cash flows from operations in order to meet our working capital requirements. We may need to borrow additional funds from our credit facility, which under certain circumstances may not be available, sell assets or seek additional equity or additional debt financing in the future. There can be no assurance that we would be able to raise such additional financing or engage in such additional asset sales on acceptable terms, or at all. If revenues were to decline and we incur net losses because our strategies to return to

F-6

Table of Contents

consistent profitability are not successful or otherwise, and if we are not able to raise adequate additional financing or proceeds from asset sales to continue to fund our ongoing operations, we will need to defer, reduce or eliminate significant planned expenditures, restructure or significantly curtail our operations.

Use of Estimates

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

Cash and Cash Equivalents

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

Fair Value of Financial Instruments

Financial instruments that are not measured at fair value include accounts receivable, accounts payable and debt. Refer to “Note 2 – Fair Value Measurements” for additional fair value information. If the Company’s revolving loan payable (see “Note 4 – Borrowings”) had been measured at fair value, it would be categorized in Level 2 of the fair value hierarchy, as the estimated value would be based on the quoted market prices for the same or similar issues or on the current rates available to the Company for debt of the same or similar terms. The carrying values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to their short-term maturities. Short-term investments are carried at fair value. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of our revolving loan payable, classified as current liability in our consolidated balance sheet, approximates its carrying amount because the interest rate is variable.

Accounts Receivable and Concentration of Credit Risk

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

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

Inventory

Inventories consist of finished goods available-for-sale and are stated at the lower of cost or net realizable 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 Asia-Pacific based suppliers of private label products and U.S.–based suppliers who are primarily drop-ship vendors. The Company believes that its products are generally available from more than one supplier and seeks to maintain multiple sources for its products, both internationally and domestically. The Company primarily purchases products in bulk quantities to take advantage of quantity discounts and to ensure inventory availability. Inventory is reported at the lower of cost or net realizable value, adjusted for slow moving, obsolete or scrap product. Inventory at December 29, 2018 and December 30, 2017 included items in-transit to our warehouses, in the amount of \$9,701 and \$10,164, respectively.

F-7

Table of Contents

Website and Software Development Costs

The Company capitalizes certain costs associated with website and software developed for internal use according to ASC 350 50 - Intangibles – Goodwill and Other – Website Development Costs and ASC 350 40 Intangibles – Goodwill and Other – Internal-Use Software, when both the preliminary project design and testing stage are completed and management has authorized further funding for the project, which it deems probable of completion and to be used for the function intended. Capitalized costs include amounts directly related to website and software development such as payroll and payroll-related costs for employees who are directly associated with, and who devote time to, the internal-use software project. Capitalization of such costs ceases when the project is substantially complete and ready for its intended use. These amounts are amortized on a straight-line basis over two to three years once the software is placed into service. The Company capitalized website and software development costs of \$3,883 and \$3,914 during fiscal year 2018 and 2017, respectively. At December 29, 2018 and December 30, 2017, our internally developed website and software costs amounted to \$19,234 and \$17,974, respectively, and the related accumulated amortization and impairment amounted to \$16,425 and \$14,429, respectively.

Long-Lived Assets and Intangibles Subject to Amortization

The Company accounts for the impairment and disposition of long-lived assets, including intangibles subject to amortization, in accordance with ASC - 360 Property, Plant and Equipment (“ASC 360”). Management assesses potential impairments whenever events or changes in circumstances indicate that the carrying value of an asset or asset group may not be recoverable. An impairment loss will result when the carrying value exceeds the undiscounted cash flows estimated to result from the use and eventual disposition of the asset or asset group. Impairment losses will be recognized in operating results to the extent that the carrying value exceeds the discounted future cash flows estimated to result from the use and eventual disposition of the asset or asset group. The Company continually uses judgment when applying these impairment rules to determine the timing of the impairment tests, undiscounted cash flows used to assess impairments, and the fair value of a potentially impaired asset or asset group. The reasonableness of our judgments could significantly affect the carrying value of our long-lived assets. At December 29, 2018 the Company’s long-lived assets did not indicate a potential impairment under the provisions of ASC 360, therefore no impairment charges were recorded for fiscal 2018.

At December 29, 2018 the Company had intangible assets with gross carrying amount, accumulated amortization and impairment, and net carrying amounts of \$4,619, \$4,154 and \$465, respectively. At December 30, 2017 the Company had intangible assets with gross carrying amount, accumulated amortization and impairment, and net carrying amounts of \$4,619, \$3,968 and \$651, respectively. The net carrying value is classified as other non-current assets on the balance sheet. The following table summarizes the future estimated annual amortization expense for these assets over the next five years and thereafter:

2019	\$ 100
2020	100
2021	100
2022	100
2023	23

Thereafter	42
Total	\$ 465

Deferred Catalog Expenses

Deferred catalog expenses consist of third-party direct costs including primarily creative design, paper, printing, postage and mailing costs for all Company direct response catalogs. Such costs are capitalized as deferred catalog expenses and are amortized over their expected future benefit period. Each catalog is fully amortized within nine months.

F-8

Table of Contents

Deferred Financing Costs

Deferred financing costs are being amortized over the life of the loan using the straight-line method as it is not significantly different from the effective interest method.

Revenue Recognition

The Company recognizes revenue from product sales and shipping revenues, net of promotional discounts and return allowances, when the following revenue recognition criteria are met: a contract has been identified, separate performance obligations are identified, the transaction price is determined, the transaction price is allocated to separate performance obligations and revenue is recognized upon satisfying each performance obligation. The Company transfers the risk of loss or damage upon shipment, therefore, revenue from product sales is recognized when it is shipped to the customer. Return allowances, which reduce product revenue by the Company's best estimate of expected product returns, are estimated using historical experience.

Revenue from sales of advertising is recorded when performance requirements of the related advertising program agreement are met. For each of the fiscal years ended 2018, and 2017, the advertising revenue represented approximately 1%, of our total revenue.

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

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

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

Sales discounts are recorded in the period in which the related sale is recognized. Sales return allowances are estimated based on historical amounts and are recorded upon recognizing the related sales. Credits are issued to customers for returned products. Credits for returned products amounted to \$19,691, and \$21,837 for fiscal year 2018, and 2017, respectively.

No customer accounted for more than 10% of the Company's net sales.

The following table provides an analysis of the allowance for sales returns and the allowance for doubtful accounts (in thousands):

Balance at	Charged to Revenue,	Balance at
------------	------------------------	------------

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

	Beginning of Period	Cost or Expenses	Deductions	End of Period
Fifty-Two Weeks Ended December 29, 2018				
Allowance for sales returns	\$ 861	\$ 19,691	\$ (19,255)	\$ 1,297
Allowance for doubtful accounts	1	66	(46)	21
Fifty-Two Weeks Ended December 30, 2017				
Allowance for sales returns	\$ 937	\$ 21,837	\$ (21,913)	\$ 861
Allowance for doubtful accounts	36	19	(54)	1

F-9

Table of Contents

Cost of Sales

Cost of sales consists of the direct costs associated with procuring parts from suppliers and delivering products to customers. These costs include direct product costs, outbound freight and shipping costs, warehouse supplies and warranty costs, partially offset by purchase discounts and cooperative advertising. Total freight and shipping expense included in cost of sales for fiscal year 2018 and 2017 was \$43,674, and \$40,565, respectively. Depreciation and amortization expenses are excluded from cost of sales and included in marketing, general and administrative and fulfillment expenses.

Warranty Costs

The Company or the vendors supplying its products provide the Company's customers limited warranties on certain products that range from 30 days to lifetime. Historically, the Company's vendors have been the party primarily responsible for warranty claims. Standard product warranties sold separately by the Company are recorded as deferred revenue and recognized ratably over the life of the warranty, ranging from one to five years. The Company also offers extended warranties that are imbedded in the price of selected private label products sold. The product brands that include the extended warranty coverage are offered at three different service levels: (a) a five year unlimited product replacement, (b) a five year one-time product replacement, and (c) a three year one-time product replacement. Warranty costs relating to merchandise sold under warranty not covered by vendors are estimated and recorded as warranty obligations at the time of sale based on each product's historical return rate and historical warranty cost. The standard and extended warranty obligations are recorded as warranty liabilities and included in other current liabilities in the consolidated balance sheets. For the fiscal year 2018 and 2017, the activity in the aggregate warranty liabilities was as follows (in thousands):

	December 29, 2018	December 30, 2017
Warranty liabilities, beginning of period	\$ 1,410	\$ 889
Additions to warranty liabilities	597	963
Reductions to warranty liabilities	(587)	(442)
Warranty liabilities, end of period	\$ 1,420	\$ 1,410

Marketing Expense

Marketing costs, including advertising, are expensed as incurred. The majority of advertising expense is paid to internet search engine service providers and internet commerce facilitators. For fiscal year 2018 and 2017, the Company recognized advertising costs of \$20,942 and \$21,055, respectively. Marketing costs also include depreciation and amortization expense and share-based compensation expense.

General and Administrative Expense

General and administrative expense consists primarily of administrative payroll and related expenses, merchant processing fees, legal and professional fees and other administrative costs. General and administrative expense also

includes depreciation and amortization expense and share-based compensation expense.

Fulfillment Expense

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

Technology Expense

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

F-10

Table of Contents

Share-Based Compensation

The Company accounts for share-based compensation in accordance with ASC 718 - Compensation – Stock Compensation (“ASC 718”). All share-based payment awards issued to employees are recognized as share-based compensation expense in the financial statements based on their respective grant date fair values, and are recognized within the statement of comprehensive income or loss as marketing, general and administrative, fulfillment or technology expense, based on employee departmental classifications. Under this standard, compensation expense for both time-based and performance-based restricted stock units is based on the closing stock price of our common shares on the date of grant, and is recognized on a straight-line basis over the requisite service period. Compensation expense for performance-based awards is measured based on the amount of shares ultimately expected to vest, estimated at each reporting date based on management’s expectations regarding the relevant performance criteria. Compensation expense for stock options is based on the fair value estimated on the date of grant using an option pricing model, and is recognized over the vesting period of three to four years. The Company currently uses the Black-Scholes option pricing model to estimate the fair value of share-based payment awards for such stock options, which is affected by the Company’s stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends.

The Company incorporates its own historical volatility into the grant-date fair value calculations for the stock options. The expected term of an award is based on combining historical exercise data with expected weighted time outstanding. Expected weighted time outstanding is calculated by assuming the settlement of outstanding awards is at the midpoint between the remaining weighted average vesting date and the expiration date. The risk-free interest rate assumption is based on observed interest rates appropriate for the expected life of awards. The dividend yield assumption is based on the Company’s expectation of paying no dividends on its common stock.

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

The Company accounts for modifications to its share-based payment awards in accordance with the provisions of ASC 718. Incremental compensation cost is measured as the excess, if any, of the fair value of the modified award over the fair value of the original award immediately before its terms are modified, measured based on the share price and other pertinent factors at that date, and is recognized as compensation cost on the date of modification (for vested awards) or over the remaining service (vesting) period (for unvested awards). Any unrecognized compensation cost remaining from the original award is recognized over the vesting period of the modified award. Forfeitures are accounted for as they occur.

Other Income, net

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

Interest Expense

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

F-11

Table of Contents

Income Taxes

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

The Company utilizes a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company considers many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. As of December 29, 2018, the Company had no material unrecognized tax benefits, interest or penalties related to federal and state income tax matters. The Company’s policy is to record interest and penalties as income tax expense.

Taxes Collected from Customers and Remitted to Governmental Authorities

We present taxes collected from customers and remitted to governmental authorities on a net basis in accordance with the guidance on ASC 605 45 50 3 - Taxes Collected from Customers and Remitted to Governmental Authorities.

Leases

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

Foreign Currency Translation

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

Comprehensive Income

The Company reports comprehensive income or loss in accordance with ASC 220 - Comprehensive Income. Accumulated other comprehensive income or loss, included in the Company's consolidated balance sheets, includes foreign currency translation adjustments related to the Company's foreign operations, of actuarial gains and losses on the Company's defined benefit plan in the Philippines. The Company presents the components of net income or loss and other comprehensive income or loss in its consolidated statements of comprehensive operations.

F-12

Table of Contents

Discontinued Operations

The Company historically operated in two reportable operating segments, the core auto parts business ("Base USAP"), and an online automotive repair information source of which we were a majority stockholder ("AutoMD"). The criteria the Company used to identify operating segments were primarily the nature of the products we sell or services we provided and the consolidated operating results that were regularly reviewed by our chief operating decision maker to assess performance and make operating decisions. On March 6, 2017, AutoMD redeemed its stock from the minority stockholders and subsequently dissolved. The AutoMD operating segment has been classified as discontinued operations for all periods presented. See "Note 12 - Discontinued Operations" for further discussion.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606), which was further updated in March, April, May and December 2016. The guidance in this update supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition". Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer. We adopted this ASU on December 31, 2017 through the modified retrospective method, with a cumulative adjustment that decreased accumulated deficit by approximately \$255. The cumulative adjustment related to no longer recording a synthetic shipping lag adjustment, as we began to recognize revenue upon shipment.

In June 2018, the FASB issued ASU 2018-07, "Compensation—Stock Compensation" (Topic 718): Improvements to Non-employee Share-based Payment Accounting, which supersedes Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees and expands the scope of ASC Topic 718, "Compensation—Stock Compensation" ("Topic 718") to include share-based payments issued to nonemployees for goods and services. The amendments also clarify that Topic 718 does not apply to share-based payments used to effectively provide financing to the issuer or awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under ASC Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. We adopted this method on December 30, 2018. The adoption of ASU 2018-07 did not have a material impact on our financial condition or results of operations.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-02, "Leases" ("ASU 2016-02"). The objective of this update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new standard is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2018. The Company will apply the new leases standard at the adoption date and recognize a cumulative adjustment to the opening balance of retained earnings as of

the adoption date. We expect to recognize additional right-of-use (“ROU”) assets and operating lease liabilities of between \$2,000 and \$2,600 on our consolidated balance sheet.

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2018 15, “Intangibles—Goodwill and Other— Internal-Use Software (Subtopic 350-40)” (“ASU 2018 15”). The objective of this update is to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The new standard is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the effect that ASU 2018 15 will have on the consolidated financial statements and related disclosures.

F-13

Table of Contents

Note 2 – 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.

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

- (a) Market Approach – uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- (b) Income Approach – uses valuation techniques to convert future estimated cash flows to a single present amount based on current market expectations about those future amounts, using present value techniques.

Financial Assets Valued on a Recurring Basis

As of December 29, 2018 and December 30, 2017, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company's cash and cash equivalents which consist primarily of money market funds and short-term investments with original maturity dates of three months or less at the date of purchase. The Company determines fair value of these assets through quoted market prices and as such they are considered Level 1 assets. Level 1 cash and cash equivalents were valued at \$2,031 and \$2,850 as of December 29, 2018 and December 30, 2017, respectively. During fiscal year 2018 and 2017 there were no transfers into or out of Level 1 and Level 2 assets.

Non-Financial Assets Valued on a Non-Recurring Basis

The Company's long-lived assets, including intangible assets subject to amortization, are measured at fair value on a non-recurring basis. These assets are measured at cost but are written-down to fair value, if necessary, as a result of impairment. As of December 29, 2018 the Company determined long-lived assets, including intangible assets, were not impaired, as such, they were not measured at fair value. The fair value measurements are categorized as Level 3 of the fair value hierarchy, as the Company developed its own assumptions and analysis to determine if such assets were impaired.

Note 3 – Property and Equipment, Net

The Company's fixed assets are stated at cost less accumulated depreciation, amortization and impairment. Depreciation and amortization expense are provided for in amounts sufficient to relate the cost of depreciable and

F-14

Table of Contents

amortizable assets to operations over their estimated service lives. Depreciation and amortization expense for fiscal year 2018 and 2017 was \$5,802 and \$6,397, respectively, which included amortization expense of \$475 in each year for capital leased assets. The cost and related accumulated depreciation of assets retired or otherwise disposed of are removed from the accounts and the resultant gain or loss is reflected in earnings. Repairs and maintenance are expensed as incurred.

Property and equipment consisted of the following at December 29, 2018 and December 30, 2017:

	December 29, 2018	December 30, 2017
Land	\$ 630	\$ 630
Building	8,877	8,877
Machinery and equipment	12,683	12,281
Computer software (purchased and developed) and equipment	23,596	22,389
Vehicles	121	85
Leasehold improvements	996	1,033
Furniture and fixtures	723	664
Construction in process	3,211	2,082
	50,837	48,041
Less accumulated depreciation and amortization	(35,653)	(32,956)
Property and equipment, net	\$ 15,184	\$ 15,085

On April 17, 2013, the Company's wholly-owned subsidiary, Whitney Automotive Group, Inc. ("WAG") entered into a sales leaseback for its facility in LaSalle, Illinois, receiving \$9,750 pursuant to a purchase and sale agreement dated April 17, 2013 between WAG and STORE Capital Acquisitions, LLC. The Company used the net proceeds of \$9,507 from this sale to reduce its revolving loan payable. Simultaneously with the execution of the purchase and sale agreement and the closing of the sale of the property, the Company entered into a lease agreement with STORE Master Funding III, LLC ("STORE") whereby we leased back the property for our continued use as an office, retail and warehouse facility for storage, sale and distribution of automotive parts, accessories and related items for 20 years, terminating on April 30, 2033. The related assets represent the amounts included in land and building in the summary above. The Company's initial base annual rent is \$853 for the first year ("Base Rent Amount"), after which the rental amount will increase annually on May 1 by the lesser of 1.5% or 1.25 times the change in the Consumer Price Index as published by the U.S. Department of Labor's Bureau of Labor Statistics, except that in no event will the adjusted annual rental amount fall below the Base Rent Amount. We were not required to pay any security deposit. Under the terms of the lease, we are required to pay all taxes associated with the lease, pay for any required maintenance on the property, maintain certain levels of insurance and indemnify STORE for losses incurred that are related to our use or occupancy of the property. The lease was accounted for as a capital lease and the \$376 excess of the net proceeds over the net carrying amount of the property is amortized in interest expense on a straight-line basis over the lease term of 20 years. As of December 29, 2018, the gross carrying value, the accumulated depreciation and the net carrying value of all capital leased assets included in property and equipment were \$11,306, \$3,969 and \$7,337, respectively. As of December 30, 2017, the gross carrying value, the accumulated depreciation and the net carrying value of all capital leased assets included in property and equipment were \$11,306, \$3,121 and \$8,185, respectively.

Construction in process primarily relates to the Company's internally developed software. Certain of the Company's net property and equipment were located in the Philippines as of December 29, 2018 and December 30, 2017, in the amount of \$129 and \$269, respectively.

Table of Contents

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

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

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

Note 4 – Borrowings

The Company maintains an asset-based revolving credit facility that provides for, among other things a revolving commitment in an aggregate principal amount of up to \$30,000, which is subject to a borrowing base derived from certain receivables, inventory and property and equipment. At December 29, 2018, our outstanding revolving loan balance was \$0. The customary events of default under the credit facility (discussed below) include certain subjective acceleration clauses, which management has determined the likelihood of such acceleration is more than remote, considering the recurring losses experienced by the Company, therefore a current classification of our revolving loan payable was required.

Loans drawn under the credit facility bear interest at a per annum rate equal to either (a) LIBOR plus an applicable margin of 1.25%, or (b) a “base rate” subject to an increase or reduction by up to 0.25% per annum based on the Company’s fixed charge coverage ratio. At December 29, 2018, the Company’s LIBOR based interest rate was 3.81% (on \$0 principal) and the Company’s prime based rate was 5.25% (on \$0 principal). A commitment fee, based upon undrawn availability under the Credit Facility bearing interest at a rate of 0.25% per annum, is payable monthly. Under the terms of the Security Agreement, cash receipts are deposited into a lock-box, which are at the Company’s discretion unless the “cash dominion period” is in effect, during which cash receipts will be used to reduce amounts owing under the Credit Agreement. The cash dominion period is triggered in an event of default or if excess availability is less than the \$3,600 for three consecutive business days, and will continue until, during the preceding 60 consecutive days, no event of default existed and excess availability has been greater than \$3,600 at all times (with the trigger subject to adjustment based on the Company’s revolving commitment). The Company’s required excess availability related to the “Covenant Testing Trigger Period” (as defined under the Credit Agreement) under the revolving commitment under the Credit Agreement is less than \$2,400 for the period commencing on any day that excess availability is less than \$2,400 for three consecutive business days, and continuing until excess availability has been greater than or equal to \$2,400 at all times for 45 consecutive days (with the trigger subject to adjustment based on the Company’s revolving commitment). The trigger, requiring the Company to provide certain reports under the Credit Agreement, relating to excess availability under the revolving commitment under the Credit Agreement is less than \$3,600 for the period commencing on any day that excess availability is less than \$3,600 for three consecutive business days, and continuing until excess availability has been greater than or equal to \$3,600 at all times for 45

consecutive days (with the trigger subject to adjustment based on the Company's revolving commitment). As of December 29, 2018, our outstanding letters of credit balance was \$14,714 of which \$11,433 was utilized and included in accounts payable in our consolidated balance sheet.

Certain of the Company's domestic subsidiaries are co-borrowers (together with the Company, the "Borrowers") under the Credit Agreement, and certain other domestic subsidiaries are guarantors (the "Guarantors" and, together with the Borrowers, the "Loan Parties") under the Credit Agreement. The Borrowers and the Guarantors are jointly and severally liable for the Borrowers' obligations under the Credit Agreement. The Loan Parties' obligations under the Credit Agreement are secured, subject to customary permitted liens and certain exclusions, by a perfected security interest in (a) all tangible and intangible assets and (b) all of the capital stock owned by the Loan Parties (limited, in the

F-16

Table of Contents

case of foreign subsidiaries, to 65% of the capital stock of such foreign subsidiaries). The Borrowers may voluntarily prepay the loans at any time. The Borrowers are required to make mandatory prepayments of the loans (without payment of a premium) with net cash proceeds received upon the occurrence of certain “prepayment events,” which include certain sales or other dispositions of collateral, certain casualty or condemnation events, certain equity issuances or capital contributions, and the incurrence of certain debt.

The Credit Agreement contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries, including, among other things, restrictions on indebtedness, liens, fundamental changes, investments, dispositions, prepayment of other indebtedness, mergers, and dividends and other distributions. The Credit Agreement requires us to obtain a prior written consent from JPMorgan Chase Bank when we determine to pay any dividends on or make any distribution with respect to our common stock. The credit facility matures on April 26, 2020.

Events of default under the Credit Agreement include: failure to timely make payments due under the Credit Agreement; material misrepresentations or misstatements under the Credit Agreement and other related agreements; failure to comply with covenants under the Credit Agreement and other related agreements; certain defaults in respect of other material indebtedness; insolvency or other related events; certain defaulted judgments; certain ERISA-related events; certain security interests or liens under the loan documents cease to be, or are challenged by the Company or any of its subsidiaries as not being, in full force and effect; any loan document or any material provision of the same ceases to be in full force and effect; and certain criminal indictments or convictions of any Loan Party.

As of December 29, 2018, the Company had capital leases payable of \$9,153. The present value of the net minimum payments on capital leases as of December 29, 2018 is as follows:

Total minimum lease payments	\$ 15,317
Less amount representing interest	(6,164)
Present value of net minimum lease payments	9,153
Current portion of capital leases payable	(594)
Capital leases payable, net of current portion	\$ 8,559

Note 5 – Stockholders’ Equity and Share-Based Compensation

Treasury Stock

In November of 2016, our Board of Directors approved a share repurchase program which authorized the Company to purchase up to \$5,000 of its outstanding shares of common stock. That share repurchase program expired on March 4, 2017. In May of 2017 our Board of Directors approved another share repurchase program which authorized the Company to purchase up to \$5,000 of its outstanding shares of common stock. That share repurchase program expired on May 16, 2018.

As of December 29, 2018, the Company repurchased 2,525 shares of common stock at an average price of \$2.83, for an aggregate purchase price of approximately \$7,146, net of costs.

Series A Convertible Preferred Stock

On March 25, 2013, the Company authorized the issuance of 4,150 shares of Series A Preferred and entered into a Securities Purchase Agreement pursuant to which the Company agreed to sell up to an aggregate of 4,150 shares of our Series A Preferred, \$0.001 par value per share at a purchase price per share of \$1.45 for aggregate proceeds to the Company of approximately \$6,017. On March 25, 2013, we sold 4,000 shares of Series A Preferred for aggregate proceeds of \$5,800. On April 5, 2013, we sold the remaining 150 shares of Series A Preferred for aggregate proceeds of \$217. The Company incurred issuance costs of \$847 and used the net proceeds from the sale of the Series A Preferred to reduce its revolving loan payable.

F-17

Table of Contents

Each share of Series A Preferred is convertible into shares of our common stock at the initial conversion rate of one share of common stock for each share of Series A Preferred. The conversion will be adjusted for certain non-price based events, such as dividends and distributions on the common stock, stock splits, combinations, recapitalizations, reclassifications, mergers, or consolidations. If not previously converted by the holder, the Series A Preferred will automatically convert to common stock if the volume weighted average price for the common stock for any 30 consecutive trading days is equal to or exceeds \$4.35 per share. The shares that would be issued if the contingently convertible Series A Preferred were converted are not excluded from the calculation of diluted earnings per share for the fiscal year ended December 30, 2017 (refer to “Note 6 – Net Loss Per Share” for anti-dilutive securities).

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

Dividends on the Series A Preferred are payable quarterly at a rate of \$0.058 per share per annum in cash, in shares of common stock or in any combination of cash and common stock as determined by the Company’s Board of Directors. Certain conditions are required to be satisfied in order for the Company to pay dividends on the Series A Preferred in shares of common stock, including (i) the common stock being registered pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934, as amended, (ii) the common stock being issued having been approved for listing on a trading market and (iii) the common stock being issued either being covered by an effective registration statement or being freely tradable without restriction under Rule 144 (subject to certain exceptions). The Series A Preferred shall each be entitled to one vote per share for each share of common stock issuable upon conversion thereof (excluding from any such calculation any dividends accrued on such shares) and shall vote together with the holders of common stock as a single class on any matter on which the holders of common stock are entitled to vote. In addition, the Company must obtain the consent of holders of at least a majority of the then outstanding Series A Preferred in connection with (a) any amendment, alteration or repeal of any provision of the certificate of incorporation or bylaws of the Company as to adversely affect the preferences, rights or voting power of the Series A Preferred, or (b) the creation, authorization or issuance of any additional Series A Preferred or any other class or series of capital stock of the Company ranking senior to or on parity with the Series A Preferred or any security convertible into, or exchangeable or exercisable for Series A Preferred or any other class or series of capital stock of the Company ranking senior to or on parity with the Series A Preferred. Concurrent with the Company’s issuance of Series A Preferred, the Company, certain of its domestic subsidiaries and JPMorgan entered into a Second Amended Credit Agreement to allow the Company to pay cash dividends on the Series A Preferred in an aggregate amount of up to \$400 per year and pay cash in lieu of issuing fractional shares upon conversion of or in payment of dividends on the Series A Preferred (refer to “Note 4 – Borrowings” of our Notes to Consolidated Financial Statements for additional details). For the fiscal year ended December 30, 2017, the Company recorded dividends of \$189. The Company did not issue any shares of common stock in payment of the fiscal 2017 dividends. There were \$41 dividends accrued as of December 30, 2017. For the fiscal year ended December 29, 2018, the Company recorded dividends of \$161. The Company did not issue any shares of common stock in payment of the fiscal 2018 dividends. There were \$41 dividends accrued as of December 29, 2018. As of December 29, 2018, 2,771 shares of Series A Preferred shares were outstanding.

Share-Based Compensation Plan Information

The Company adopted the 2016 Equity Incentive Plan ("2016 Equity Plan") on March 9, 2016, which became effective on May 31, 2016, following stockholder approval. Subject to adjustment for certain changes in the Company's capitalization, the aggregate number of shares of the Company's common stock that may be issued under the 2016 Equity Plan will not exceed the sum of (i) two million five hundred thousand (2,500) new shares, (ii) the number of unallocated shares remaining available for the grant of new awards under the Company's prior equity plans described

F-18

Table of Contents

below (the “Prior Equity Plans”) as of the effective date of the 2016 Plan (which was equal to 3,894 shares as of May 31, 2016) and (iii) any shares subject to a stock award under the Prior Equity Plans that are not issued because such stock award expires or otherwise terminates without all of the shares covered by such stock award having been issued, that are not issued because such stock award is settled in cash, that are forfeited back to or repurchased by the Company because of the failure to meet a contingency or condition required for the vesting of such shares, or that are reacquired, withheld (or not issued) to satisfy a tax withholding obligation in connection with an award or to satisfy the purchase price or exercise price of a stock award. In addition, the share reserve will automatically increase on January 1st of each year, for a period of nine years, commencing on January 1, 2017 and ending on (and including) January 1, 2026, in an amount equal to one million five hundred thousand (1,500) shares per year; however the Board of Directors of the Company may act prior to January 1st of a given year to provide that there will be no January 1st increase in the share reserve for such year or that the increase in the share reserve for such year will be a lesser number of shares of common stock than would otherwise occur pursuant the automatic increase. Options granted under the 2016 Equity Plan generally expire no later than ten years from the date of grant and generally vest over a period of four years. The exercise price of all option grants must be equal to 100% of the fair market value on the date of grant. As of December 29, 2018, 7,733 shares were available for future grants under the 2016 Equity Plan.

The following tables summarizes the Company’s stock option activity for the fiscal years ended, and details regarding the options outstanding and exercisable at December 29, 2018, and December 30, 2017:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value(1)
Options outstanding, December 30, 2017	5,933	\$ 2.91		
Granted	1,174	\$ 2.02		
Exercised	(6)	\$ 0.99		
Cancelled:				
Forfeited	(188)	\$ 3.10		
Expired	(816)	\$ 3.21		
Options outstanding, December 29, 2018	6,097	\$ 2.69	4.42	\$ —
Vested and expected to vest at December 29, 2018	6,097	\$ 2.69	4.40	\$ —
Options exercisable, December 29, 2018	3,956	\$ 2.77	3.90	\$ —

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value(1)
Options outstanding, December 31, 2016	6,129	\$ 2.81		
Granted	1,445	\$ 3.34		
Exercised	(1,074)	\$ 1.67		
Cancelled:				
Forfeited	(161)	\$ 2.16		
Expired	(406)	\$ 6.50		
Options outstanding, December 30, 2017	5,933	\$ 2.91	6.28	\$ 1,337

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

Vested and expected to vest at December 30, 2017	5,933	\$ 2.91	6.28	\$ 1,337
Options exercisable, December 30, 2017	3,704	\$ 2.78	4.79	\$ 1,236

(1) These amounts represent the difference between the exercise price and the closing price of U.S. Auto Parts Network, Inc. common stock at the end of the respective fiscal year as reported on the NASDAQ Stock Market, for all options outstanding that have an exercise price currently below the closing price.

The weighted-average fair value of options granted during fiscal year 2018 and 2017 was \$1.11 and \$1.85, respectively. The intrinsic value of stock options at the date of the exercise is the difference between the fair value of the

F-19

Table of Contents

stock at the date of exercise and the exercise price. During fiscal year 2018 2017, the total intrinsic value of the exercised options was \$1 and \$1,911, respectively. The Company had \$2,701 of unrecognized share-based compensation expense related to stock options outstanding as of December 29, 2018, which expense is expected to be recognized over a weighted-average period of 2.08 years.

The following tables summarize the Company's stock option activity under the AutoMD 2014 Equity Incentive Plan (the "AMD Plan") for the fiscal year ended, and details regarding AutoMD options outstanding and exercisable at December 30, 2017:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding, December 31, 2016	1,405	\$ 1.00		
Granted	—	\$ —		
Exercised	—	\$ —		
Cancelled:				
Forfeited	(1,405)	\$ 1.00		
Expired	—	\$ —		
Options outstanding, December 30, 2017	—	\$ —	0.00	\$ —
Vested and expected to vest at December 30, 2017	—	\$ —	0.00	\$ —
Options exercisable, December 30, 2017	—	\$ —	0.00	\$ —

The weighted-average fair value of options granted during fiscal 2017 was \$0.55.

Options exercised under all share-based compensation plans are granted net of the minimum statutory withholding requirements that we pay in cash to the appropriate taxing authorities on behalf of our employees. For those employees who do not receive shares net of the minimum statutory withholding requirements, the appropriate taxes are paid directly by the employee. During fiscal 2018, we withheld 0 shares to satisfy \$0 of employees' tax obligations related to the net settlement of the stock options. During fiscal 2017, we withheld 260 shares to satisfy \$900 of employees' tax obligations related to the net settlement of the stock options.

Restricted Stock Units

During 2018 and 2017 the Company granted an aggregate of 1,212 and 1,671 RSUs, respectively, to certain employees of the Company. The restricted stock units ("RSUs") were granted under the 2016 Equity Incentive Plan and reduced the pool of equity instruments available under that plan.

During 2018 there were 510 RSUs granted that were time-based and 702 granted that were performance-based. During 2017 there were 1,144 RSUs granted that were time-based and 527 granted that were performance-based. As of December 29, 2018, none of the performance criteria established to trigger automatic vesting of the performance based RSUs ("PSUs") was met subject to certification by the Compensation Committee. As of December 29, 2018, 222 PSUs are subject to acceleration for two named executive officers ("NEOs") in accordance with the terms of their separation and grant agreements. 54 PSUs and 10 RSUs granted during 2018 were forfeited during the year. As of July 9, 2018, 131 PSUs granted in 2017 met the performance criteria upon certification by the Compensation Committee and 292 PSUs were forfeited. As of December 30, 2017, 57.4% of the performance criteria established to

trigger vesting of the PSUs was met subject to certification by the Compensation Committee. No PSUs vested for the Company's NEOs. 104 PSUs and 799 RSUs granted during 2017 were forfeited during 2017. The vesting of each RSU is subject to the employee's continued employment through applicable vesting dates. Some RSUs granted to certain executives may vest on an accelerated basis in part or in full upon the occurrence of certain events. The RSUs are accounted for as equity awards and are measured at fair value based upon the grant date price of the Company's common stock. The closing price of the Company's common stock on January 5, 2018, January 8, 2018, and July 9, 2018, the date of each grant was \$2.62, \$2.61, and \$1.54, respectively. The closing price of the Company's common stock on January 19, 2017, January 25,

F-20

Table of Contents

2017, March 30, 2017, May 11, 2017, August 9, 2017 and November 8, 2017, the date of each grant was \$3.61, \$3.40, \$3.34, \$3.93, \$2.77, and \$2.27, respectively. Compensation expense is recognized on a straight-line basis over the requisite service period of one-to-three years. Compensation expense for performance-based awards is measured based on the amount of shares ultimately expected to vest, estimated at each reporting date based on management's expectations regarding the relevant performance criteria.

For the fiscal year ended December 29, 2018, we recorded compensation expense of \$2,100 related to RSU's. As of December 29, 2018, there was unrecognized compensation expense of \$74 related to unvested RSUs based on awards that are expected to vest. The unrecognized compensation expense is expected to be recognized over a weighted-average period of 1.05 years.

Warrants

On May 5, 2009, the Company issued warrants to purchase up to 30 shares of common stock at an exercise price of \$2.14 per share. On April 27, 2010, the Company issued additional warrants to purchase up to 20 shares of common stock at an exercise price of \$8.32 per share. Both issuances of warrants terminated seven years after their grant date. The warrants were issued in connection with the financial advisory services provided by a consultant to the Company. On August 8, 2016, 10 shares of common stock were issued in settlement of the May 5, 2009 warrants. The 20 shares of common stock from the April 27, 2010 expired on April 26, 2017. As of December 29, 2018, no warrants were outstanding and exercisable.

Share-Based Compensation Expense

The fair value of each option grant, excluding those options issued from the stock option exchange program as discussed above, was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions for each of the periods ended:

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Expected life	5.62 - 5.73 years	5.54 - 5.70 years
Risk-free interest rate	2% - 3%	2%
Expected volatility	58%	59% - 61%
Expected dividend yield	—%	—%

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

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Marketing expense	\$ 185	\$ 426
General and administrative expense	2,984	1,906
Fulfillment expense	284	372
Technology expense	142	138
Total share-based compensation expense	\$ 3,595	\$ 2,842

The share-based compensation expense is net of amounts capitalized to internally-developed software of \$49 and \$56 during the fiscal year 2018 2017, respectively. No tax benefit was recognized for fiscal years 2018 2017 due to the valuation allowance position.

Under ASC 718, we recognize forfeitures as they occur.

F-21

Table of Contents

Note 6 – Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Net income per share:		
Numerator:		
(Loss) income from continuing operations	\$ (4,889)	\$ 24,574
Dividends on Series A Convertible Preferred Stock	(161)	(189)
(Loss) income from continuing operations available to common shares	\$ (5,050)	\$ 24,385
Denominator:		
Weighted-average common shares outstanding (basic)	34,941	35,192
Common equivalent shares from common stock options, restricted stock, preferred stock and warrants	—	4,442
Weighted-average common shares outstanding (diluted)	34,941	39,634
Basic net (loss) income from continuing operations per share	\$ (0.14)	\$ 0.69
Diluted net (loss) income from continuing operations per share	\$ (0.14)	\$ 0.62

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

	Fiscal Year	
	December 29, 2018	December 30, 2017
Common stock warrants	—	6
Performance stock units	204	—
Restricted stock units	760	383
Series A Convertible Preferred Stock	2,771	—
Options to purchase common stock	6,123	3,357
Total	9,858	3,746

Note 7 – Income Taxes

The components of income (loss) from continuing operations before income tax provision consist of the following:

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Domestic operations	\$ (5,696)	\$ 2,553
Foreign operations	479	481
Total (loss) income before income taxes	\$ (5,217)	\$ 3,034

Table of Contents

Income tax (benefit) provision for fiscal year 2018 and 2017 consists of the following:

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Current:		
Federal tax	\$ —	\$ —
State tax	6	6
Foreign tax	111	115
Total current taxes	117	121
Deferred:		
Federal tax	(490)	2,118
State tax	537	1,122
Foreign tax	—	—
Total deferred taxes	47	3,240
Change in federal tax rate - deferred tax impact	—	12,171
Valuation allowance	(493)	(37,072)
Income tax provision	\$ (329)	\$ (21,540)

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

	December 29, 2018	December 30, 2017
Income tax at U.S. federal statutory rate	\$ (1,096)	\$ 1,032
Change in U.S. federal statutory rate	—	12,171
Tax attributes written off	522	1,110
Share-based compensation	727	1,027
State income tax, net of federal tax effect	(66)	231
Foreign tax	68	(77)
Other	9	38
Change in valuation allowance	(493)	(37,072)
Effective tax benefit	\$ (329)	\$ (21,540)

For fiscal years 2018 and 2017 the effective tax rate for the Company was 6.3% and (710.0)%, respectively. The Company's effective tax rate for fiscal year 2018 differs from the U.S. federal rate primarily as a result of non-deductible share-based compensation, the write-off of expired state net operating loss carryforwards, and the change in the valuation allowance maintained against the Company's deferred tax assets. The Company's effective tax rate for fiscal year 2017 differs from the U.S. federal rate primarily as a result of the release of valuation allowances against the Company's deferred tax assets.

Table of Contents

Deferred tax assets and deferred tax liabilities consisted of the following:

	December 29, 2018	December 30, 2017
Deferred tax assets:		
Inventory and inventory related allowance	\$ 639	\$ 537
Share-based compensation	2,119	2,281
Intangibles	2,415	3,702
Sales and bad debt allowances	718	603
Vacation accrual	202	145
Book over tax amortization on property and equipment	193	677
Net operating loss	21,345	19,740
Other	86	101
Total deferred tax assets	27,717	27,786
Valuation Allowance	(5,816)	(6,309)
Net deferred tax assets	21,901	21,477
Deferred tax liabilities:		
Prepaid catalog expenses	68	1
Total deferred tax liabilities	68	1
Net deferred tax assets	\$ 21,833	\$ 21,476

At December 29, 2018, federal and state net operating loss (“NOL”) carryforwards were \$74,418 and \$72,152, respectively. Federal NOL carryforwards of \$2,106 were acquired in the acquisition of WAG which are subject to Internal Revenue Code section 382 and limited to an annual usage limitation of \$135. Federal NOL carryforwards begin to expire in 2029, and the state NOL carryforwards expire in the respective tax years as follows:

2019	\$ 917
2020	673
2021	5,474
2022	1,027
2023	3,058
Thereafter	61,003
	\$ 72,152

Under the provisions of ASC 740, management is required to evaluate whether a valuation allowance should be established against its deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard. Realization of deferred tax assets is dependent upon taxable income in prior carryback years, estimates of future taxable income, tax planning strategies, and reversal of existing taxable temporary differences. ASC 740 provides that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years or losses expected in early future years. As of December 30, 2017, the Company’s deferred tax assets were primarily the result of U.S. federal and state net operating loss carryforwards. A valuation allowance of \$43,877 was recorded against our gross deferred tax asset balance as of December 31, 2016. As of December 30, 2017 in part because in the year then ended the Company achieved three years of cumulative pre-tax income in the U.S. federal tax jurisdiction, management determined that sufficient positive evidence existed to conclude that it was more likely than not that deferred taxes of \$32,153 were realizable, and therefore, reduced the valuation allowance accordingly. As of December 29, 2018 the Company continued to maintain a valuation allowance

in the amount of \$5,816 against deferred tax assets that were more likely than not of being recognized.

The Tax Cuts and Jobs Act was enacted on December 22, 2017 and reduced the U.S. federal corporate tax rate to 21 percent, effective January 1, 2018. Consequently, we have recorded a decrease in our deferred tax assets, deferred tax liabilities and valuation allowance of \$13,630, \$1,459 and \$1,494, respectively, with a corresponding net adjustment to deferred income tax expense of \$10,677 for the year ended December 30, 2017. In addition, we recognized a deemed repatriation of \$1,123 of deferred foreign income from our Philippines subsidiary, which did not result in any incremental tax cost after application of foreign tax credits.

F-24

Table of Contents

We are subject to U.S. federal income tax as well as income tax of foreign and state tax jurisdictions. The tax years 2014-2018 remain open to examination by the major taxing jurisdictions to which the Company is subject, except the Internal Revenue Service for which the tax years 2015-2018 remain open. The Company does not anticipate a significant change to the amount of unrecognized tax benefits within the next twelve months.

Included in accrued expenses are income taxes payable of \$23 and \$3 for the fiscal year 2018 and 2017 respectively, consisting primarily of current foreign taxes. Included in other non-current liabilities are income taxes payable of \$614 and \$601 for the fiscal year 2018 and 2017, respectively, relating to future foreign withholding taxes.

Note 8 – Commitments and Contingencies

Facilities Leases

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

Facility rent expense for fiscal year ended 2018 and 2017 was \$1,752, and \$1,734, respectively. The Company's facility rent expense did not include any amounts charged from a related party during fiscal years 2018 and 2017.

On February 4, 2016, the Company entered into a lease for its distribution center located in Chesapeake, Virginia. The Lease between the Company and Liberty Property Limited Partnership is for approximately 159,294 square feet. The initial three-year term of the Lease commenced on July 1, 2016 and is set to expire in June of 2019. The Company is obligated to pay approximately \$640 in annual base rent, which shall increase by approximately 2.5% each year. The Company is also obligated to pay certain operating expenses set forth in the Lease. Pursuant to the Lease, the Company has the option to extend the Lease for an additional three-year term, with certain increases in base rent. The monthly base rent commitment was \$56 as of December 29, 2018.

In January 2010, the Company's Philippines subsidiary entered into a lease agreement. Under the terms of the lease agreement, effective March 1, 2010, the monthly rent was approximately \$25, and became subject to 5% annual escalation beginning on the 3rd year of the lease term. The lease renewed for a sixty month term upon mutual agreement of both parties during 2015.

As described in detail under "Note 3 – Property and Equipment Net", on April 17, 2013, the Company entered into a sale lease-back agreement with STORE Master Funding III, LLC ("STORE") whereby we leased back our facility located in LaSalle, Illinois for our continued use as an office, retail and warehouse facility for storage, sale and distribution of automotive parts, accessories and related items for 20 years commencing upon the execution of the lease and terminating on April 30, 2033. The related assets for the sale lease-back land and building is represented by the amount included in leased facility in the summary above. The Company's initial base annual rent is \$853 for the first year ("Base Rent Amount"), after which the rental amount will increase annually on May 1 by the lesser of 1.5% or 1.25 times the change in the Consumer Price Index as published by the U.S. Department of Labor's Bureau of Labor Statistics, except that in no event will the adjusted annual rental amount fall below the Base Rent Amount. We were not required to pay any security deposit. Under the terms of the lease, we are required to pay all taxes associated with the lease, pay for any required maintenance on the property, maintain certain levels of insurance and indemnify STORE for losses incurred that are related to our use or occupancy of the property. The lease was accounted for as a capital lease and the \$376 excess of the net proceeds over the net carrying amount of the property is amortized in interest expense on a straight-line basis over the lease term of 20 years. As of December 29, 2018, the net carrying value of all capital leased assets included in property and equipment was \$7,337.

Table of Contents

Minimum lease commitments under non-cancelable operating leases as of December 29, 2018 are as follows:

2019	\$ 1,177
2020	538
Total	\$ 1,715

Capital lease commitments as of December 29, 2018 were as follows:

2019	\$ 1,277
2020	1,129
2021	962
2022	971
2023	985
Thereafter	9,993
Total minimum payments required	15,317
Less amount representing interest	6,164
Present value of minimum capital lease payments	\$ 9,153

Legal Matters

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

Customs Issues. On April 2, 2018, the Company filed a complaint against the United States of America, the United States Department of Homeland Security ("DHS"), Secretary Kirstjen Nielsen, and Chief Frederick Eisler (collectively, the "Defendants") in the United States Court of International Trade (the "Court") (Case No. 1:18-cv-00068) seeking (i) relief from a single entry bonding requirement set by the United States Customs and Border Protection ("CBP"), an agency of DHS, at a level equivalent to three times the commercial invoice value of each shipment (the "Bonding Requirement"), (ii) a declaration that the Bonding Requirement is unlawful, (iii) an injunction prohibiting additional delayed entry for all of the Company's currently-held goods being denied entry into the United States by CBP and all of the Company's future imports, and (iv) recovery of our attorneys' fees incurred in connection with the action. The genesis for the action is CBP's wrongful seizure of aftermarket vehicle grilles and associated parts being imported by the Company ("Repair Grilles") on the basis that the Repair Grilles allegedly bear counterfeit trademarks of the original automobile manufacturers (i.e., original-equipment manufacturers, or "OEMs"). Generally, these trademarks, as applied against the Company, purport to cover the shape of the grilles themselves, or the OEM's logo or name. However, the Repair Grilles are not counterfeit and do not cause a likelihood of confusion amongst purchasers or the relevant consuming public which are prerequisites for seizures under the pertinent provision of the Tariff Act being relied upon by CBP to seize the Repair Grilles.

On May 25, 2018, the Court granted the Company's motion for preliminary injunction and ordered that (i) the Defendants are restrained from enforcing the 3X Bonding Requirement, the Three Percent Bonding Requirement, and any other enhanced bonding requirement on the Company in order to obtain entry of its shipments into the United States, and (ii) CBP shall use its best efforts to process all of the Company's shipping containers and release all of the Company's imports not implicated by CBP's underlying trademark infringement allegations in a timely manner. The Court's decision was not appealed by DHS and the matter is no longer pending before the Court. The Court's May 25, 2018 decision is described herein in summary fashion only. The full text of the decision should be read in its entirety. Copies of the decision are available on the Court's electronic filing system (located on the Court's docket at No. 18-00068).

F-26

Table of Contents

Despite the favorable court order, the Company continued to experience issues with product flow arising from CBP's inability to process the Company's shipping containers in an expeditious fashion. As a result, the Company incurred significant port and carrier fees resulting from the increased period of time the Company's containers remained at the port. The fees associated with this unreleased product, as well as the increased legal costs associated with the product seizures and the bonding litigation, aggregated to \$5,046 during fiscal 2018. As of December 29, 2018, all product not implicated by the trademark infringement allegations has been released by CBP.

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

Related Party Matters

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

Note 9 – Employee Retirement Plan and Deferred Compensation Plan

Effective February 17, 2006, the Company adopted a 401(k) defined contribution retirement plan covering all full time employees who have completed one month of service. The Company may, at its sole discretion, match fifty cents per dollar up to 6% of each participating employee's salary. The Company's contributions vest in annual installments over three years. Discretionary contributions made by the Company totaled \$292 and \$286 for fiscal year 2018 and 2017, respectively.

In January 2010, the Company adopted the U.S. Auto Parts Network, Inc. Management Deferred Compensation Plan (the "Deferred Compensation Plan"), for the purpose of providing highly compensated employees a program to meet their financial planning needs. The Deferred Compensation Plan provides participants with the opportunity to defer up to 90% of their base salary and up to 100% of their annual earned bonus, all of which, together with the associated investment returns, are 100% vested from the outset. The Deferred Compensation Plan, which is designed to be exempt from most provisions of the Employee Retirement Security Act of 1974, is informally funded by the Company through the purchase of Company-owned life insurance policies with the Company (employer) as the owner and beneficiary, in order to preserve the tax-deferred savings advantages of a non-qualified plan. The plan assets are the cash surrender value of the Company-owned life insurance policies and not associated with the deferred compensation liability. The deferred compensation liabilities (consisting of employer contributions, employee deferrals and associated earnings and losses) are general unsecured obligations of the Company. Liabilities under the Deferred Compensation Plan are recorded at amounts due to participants, based on the fair value of participants' selected investments. The Company may at its discretion contribute certain amounts to eligible employee accounts. In January 2010, the Company began to contribute 50% of the first 2% of participants' eligible contributions into their Deferred Compensation Plan accounts. In September 2010, the Company established and transferred its ownership to a rabbi trust to hold the Company-owned life insurance policies. As of December 29, 2018, the assets and associated liabilities of the Deferred Compensation Plan were \$533 and \$662, respectively, and were \$579 and \$675, respectively, as of December 30, 2017 and are included in other non-current assets, other current liabilities and other non-current liabilities in our consolidated balance sheets. For fiscal year 2018, the change in the associated liabilities include the employee contributions of \$120, the Company contributions of \$28, and unrealized earnings of \$107, partially offset by distributions of \$111. For fiscal year 2017, the associated liabilities primarily include the employee

contributions of \$136 and the Company contributions of \$26 offset by unrealized earnings of \$110 and distributions of \$281. For fiscal year 2018, included in other income, the Company recorded a net loss of \$46 for the change in the cash surrender value of the Company-owned life insurance policies. For fiscal year 2017, included in other income, the Company recorded net earnings of \$5 for the change in the cash surrender value of the Company-owned life insurance policies.

F-27

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

Basic income (loss) from continuing operations per share as reported and adjusted					
Diluted income (loss) from continuing operations per share as reported and adjusted	\$ 0.01	\$ (0.01)	\$ 0.02	\$ (0.02)	\$ (0.13)
Shares used in computation of basic income (loss) from continuing operations per share as reported and adjusted	34,983	34,983	34,925	34,925	34,989
Shares used in computation of diluted income (loss) from continuing operations per share as reported and adjusted	35,201	34,983	35,279	34,925	34,989

F-28

Table of Contents

The company has recorded an error correction to recognize abnormal costs related to our customs issues. For the quarters ended March 31, 2018, June 30, 2018 and September 29, 2018, the Company revised net income by \$0.2 million, \$0.3 million and \$0.6 million, respectively, to recognize the abnormal costs.

	Quarter Ended			
	April 1, 2017	July 1, 2017	Sept. 30, 2017	Dec. 30, 2017
Consolidated Statement of Income Data:				
Net sales	\$ 80,833	\$ 80,208	\$ 73,807	\$ 68,518
Gross profit	23,787	23,244	21,877	20,752
Income (loss) from operations	1,205	1,509	1,332	589
Income (loss) from continuing operations before income taxes	843	1,059	947	185
Income (loss) from continuing operations	816	26,918	919	(4,079)
Loss on discontinued operations	(559)	—	—	—
Net income (loss)	\$ 257	\$ 26,918	\$ 919	\$ (4,079)
Basic income (loss) from continuing operations per share as reported and adjusted	\$ 0.02	\$ 0.76	\$ 0.02	\$ (0.12)
Diluted income (loss) from continuing operations per share as reported and adjusted	\$ 0.02	\$ 0.67	\$ 0.02	\$ (0.12)
Shares used in computation of basic income (loss) from continuing operations per share as reported and adjusted	34,510	35,332	35,856	35,070
Shares used in computation of diluted income (loss) from continuing operations per share as reported and adjusted	39,959	39,933	39,485	35,070

Note 11 – Product Information

As described in Note 1 above, the Company's products consist of collision parts serving the body repair market, engine parts to serve the replacement parts market, and performance parts and accessories. The following table summarizes the approximate distribution of the Company's revenue by product type.

	2018		2017	
Private Label				
Collision	57	%	54	%
Engine	18	%	18	%
Performance	1	%	1	%
Branded				
Collision	1	%	2	%
Engine	11	%	10	%

Performance	12	%	15	%
Total	100	%	100	%

Note 12 – Discontinued Operations

On March 6, 2017, AutoMD filed for dissolution. The AutoMD operating segment has been classified as discontinued operations and its results of operations are reflected under loss from discontinued operations in our consolidated financial statements.

F-29

Table of Contents

The following table summarizes the results of discontinued operations:

	Fiscal Year Ended	
	December 29, 2018	December 30, 2017
Net Sales	\$ -	\$ 37
Loss from operations and disposal of discontinued AutoMD operations	—	(558)
Income tax provision	—	1
Loss from discontinued operations	\$ -	\$ (559)

Loss from operations and disposal of discontinued AutoMD operations for fiscal 2017 consisted of severance costs of \$221, contract termination costs of \$164 as well as loss from operations of \$173, and included net loss attributable to noncontrolling interests of \$59.

F-30
