

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from _____ to _____

Commission file number: 001-33264



U.S. AUTO PARTS NETWORK, INC.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

68-0623433

*(I.R.S. Employer
Identification No.)*

**17150 South Margay Avenue
Carson, CA 90746**

(Address of Principal Executive Office) (Zip Code)

(310) 735-0085

(Registrant's telephone number, including area code)

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

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

Large Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company)

Accelerated Filer

Smaller Reporting Company

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

As of November 3, 2008, the registrant had 29,846,757 shares of common stock, \$0.001 par value, outstanding.

U.S. AUTO PARTS NETWORK, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008

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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, and the term "Partsbin" refers to All OEM Parts, Inc., ThePartsBin.com, Inc. and their affiliated companies, which we acquired and merged into our wholly-owned subsidiary, Partsbin, Inc., in May 2006.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains statements that do not relate strictly to historical or current facts, and anticipate results based on management's beliefs and assumptions and on information currently available to management. These statements are forward looking statements for the purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 27A of the Securities Act of 1933 (the "Securities Act"). In some cases, you can identify forward-looking statements by terms such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "projects," "should," "will," "would" and similar expressions intended to identify forward-looking statements. These forward-looking statements include but are not limited to statements regarding our anticipated sales, revenue, expenses, profits and losses, capital needs, capital deployment, liquidity, contracts, litigation, product offerings, customers, acquisitions, competition and the status of our facilities. Forward-looking statements, no matter where they occur in this document or in other statements attributable to the Company involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. We discuss many of these risks in greater detail under the heading "Risk Factors" in Part II, Item 1A of this report. Given these uncertainties, you should not place undue reliance on these forward-looking statements. You should read this report and the documents that we reference in this report and have filed as exhibits to the report completely and with the understanding that our actual future results may be materially different from what we expect. Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

U.S. AUTO PARTS NETWORK, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts and par value)

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
	<u>(unaudited)</u>	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 33,122	\$ 19,399
Marketable securities	—	22,650
Accounts receivable, net	1,489	2,907
Inventory, net	12,105	11,191
Deferred income taxes	831	831
Other current assets	2,953	1,808
Total current assets	<u>50,500</u>	<u>58,786</u>
Property and equipment, net	7,210	6,945
Intangible assets, net	3,710	26,444
Goodwill	14,201	14,201
Deferred income taxes	12,428	3,562
Investments	6,351	—
Other non-current assets	116	118
Total assets	<u>\$ 94,516</u>	<u>\$ 110,056</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 5,821	\$ 8,103
Accrued expenses	6,916	7,822
Notes payable	—	1,000
Capital leases payable, current portion	66	73
Other current liabilities	1,573	1,367
Total current liabilities	<u>14,376</u>	<u>18,365</u>
Capital leases payable, less current portion	—	48
Total liabilities	<u>14,376</u>	<u>18,413</u>
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value; 100,000,000 shares authorized at September 30, 2008 and December 31, 2007; 29,846,757 shares issued and outstanding at September 30, 2008 and December 31, 2007	30	30
Additional paid-in capital	145,534	143,223
Accumulated other comprehensive income (loss)	(73)	312
Accumulated deficit	(65,351)	(51,922)
Total stockholders' equity	<u>80,140</u>	<u>91,643</u>
Total liabilities and stockholders' equity	<u>\$ 94,516</u>	<u>\$ 110,056</u>

See accompanying notes to unaudited condensed consolidated financial statements.

U.S. AUTO PARTS NETWORK, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net sales	\$ 36,554	\$ 37,787	\$ 119,668	\$ 123,642
Cost of sales	24,485	24,096	79,262	82,497
Gross profit	12,069	13,691	40,406	41,145
Operating expenses ⁽¹⁾ :				
General and administrative	4,170	3,184	13,381	9,715
Marketing	5,240	4,917	17,842	15,738
Fulfillment	2,322	1,920	6,787	5,499
Technology	1,041	438	2,512	1,394
Amortization of intangibles and impairment loss	365	2,097	23,005	6,251
Total operating expenses	13,138	12,556	63,527	38,597
Income (loss) from operations	(1,069)	1,135	(23,121)	2,548
Other income:				
Other income (loss)	(22)	3	(17)	8
Interest income, net	238	389	741	654
Total other income	216	392	724	662
Income (loss) before income taxes	(853)	1,527	(22,397)	3,210
Income tax provision (benefit)	(362)	633	(8,968)	1,309
Net income (loss)	\$ (491)	\$ 894	\$ (13,429)	\$ 1,901
Basic and diluted net income (loss) per share	\$ (0.02)	\$ 0.03	\$ (0.45)	\$ 0.07
Shares used in computation of basic net income (loss) per share	29,846,757	29,837,538	29,846,757	27,744,016
Shares used in computation of diluted net income (loss) per share	29,846,757	30,009,891	29,846,757	28,749,521

⁽¹⁾ Includes share-based compensation expense as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
General and administrative	\$ 541	\$ 389	\$ 1,545	\$ 1,196
Marketing	62	93	257	248
Fulfillment	37	29	100	70
Technology	110	21	166	48
Total share-based compensation expense	\$ 750	\$ 532	\$ 2,068	\$ 1,562

See accompanying notes to unaudited condensed consolidated financial statements.

U.S. AUTO PARTS NETWORK, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended	
	September 30,	
	2008	2007
Operating activities		
Net income (loss)	\$ (13,429)	\$ 1,901
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,674	870
Amortization of intangibles	4,560	6,251
Impairment loss on intangibles	18,445	—
Non-cash interest expense	—	273
Loss from disposition of assets	23	—
Share-based compensation expense	2,068	1,562
Deferred income taxes	(8,866)	—
Changes in operating assets and liabilities:		
Accounts receivable, net	1,418	302
Inventory, net	(914)	(3,147)
Other current assets	(1,162)	(748)
Other non-current assets	(8)	1,719
Accounts payable and accrued expenses	(3,080)	(1,442)
Other current liabilities	207	(639)
Net cash provided by operating activities	1,936	6,902
Investing activities		
Additions to property and equipment	(2,894)	(3,488)
Proceeds from the sale of marketable securities	21,650	—
Purchases of marketable securities	(5,500)	(25,000)
Cash paid for intangible assets	(414)	(1,286)
Net cash provided by (used in) investing activities	12,842	(29,774)
Financing activities		
Payments on line of credit	—	(2,000)
Payments on notes payable	(1,000)	(32,000)
Proceeds received on issuance of common stock in connection with initial public offering, net of offering costs	—	71,537
Payments of short-term financing	(56)	(51)
Proceeds from exercise of stock options	—	94
Net cash provided by (used in) financing activities	(1,056)	37,580
Effect of changes in foreign currencies	1	97
Net increase in cash and cash equivalents	13,723	14,805
Cash and cash equivalents at beginning of period	19,399	2,381
Cash and cash equivalents at end of period	<u>\$ 33,122</u>	<u>\$ 17,186</u>

See accompanying notes to unaudited condensed consolidated financial statements.

U.S. AUTO PARTS NETWORK, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements of U.S. Auto Parts Network, Inc. (collectively with its subsidiaries, the "Company") have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions to Securities and Exchange Commission ("SEC") Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of September 30, 2008 and December 31, 2007, and the consolidated results of operations for the three and nine months ended September 30, 2008 and 2007, and cash flows for the nine months ended September 30, 2008 and 2007. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. The Company's results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of those to be expected for the entire year. The accompanying consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2007, which was filed with the SEC on April 2, 2008.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, but are not limited to, the valuation of investments, the valuation of inventory, valuation of deferred tax assets and liabilities, estimated useful lives of property, equipment and software, valuation of intangible assets, including goodwill, recoverability of software development costs, estimation of sales returns and allowances, and the provision for doubtful accounts. These estimates are based on current facts, historical experience and various other factors that the Company believes to be reasonable under the circumstances. Actual results could differ from these estimates.

Impairment of Long-Lived Assets

During the second quarter of 2008, the Company recorded a non-cash impairment charge on long-lived assets totaling \$18.4 million as further described in Note 4 to the unaudited condensed consolidated financial statements included in this report.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141 (revised 2007), "*Business Combinations*" ("SFAS 141R"), which replaces SFAS No. 141, "*Business Combinations*" and establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. SFAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early adoption of SFAS 141R is prohibited. The Company will apply SFAS 141R to any acquisition occurring after January 1, 2008.

In April 2008, the FASB issued FASB Staff Position ("FSP") No. 142-3, "*Determination of the Useful Life of Intangible Assets*" ("FSP 142-3"). FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life or recognized intangible assets under SFAS No. 142, "*Goodwill and Other Intangible Assets*" ("SFAS 142"). This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The Company does not expect the adoption of FSP 142-3 will have a material effect on its financial position and results of operations.

Reclassifications

Certain reclassifications have been made to prior year financial statements in order to conform to current year presentation.

Seasonality

The Company has historically experienced seasonality in its business. The Company expects seasonality to continue in future years as automobile collisions during inclement weather generally create increased demand for auto body parts in winter months and consumers often undertake projects to maintain and enhance the performance of their automobiles in the summer months. The Company anticipates that seasonality will continue to have a material impact on the Company's financial condition and results of operations in future years.

Note 2—Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued SFAS No. 157-2, "Effective Date of FASB Statement No. 157" ("SFAS 157-2"), which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company has adopted the provisions of SFAS 157 as of January 1, 2008 for financial assets including cash and cash equivalents and marketable securities and SFAS 157-2 as of June 30, 2008 for intangible assets.

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

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

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

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

Recurring Financial Assets

As of September 30, 2008, the Company held certain assets that are required to be measured at fair value on a recurring basis. These assets included the Company's financial instruments, including investments associated with auction rate preferred securities ("ARPS"). The Company measures the following financial assets at fair value on a recurring basis. The fair value of these financial assets was determined using the following inputs at September 30, 2008:

	Total as of September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Cash and cash equivalents ⁽¹⁾	\$ 33,122	\$ 33,122	\$ —	\$ —
Non-current investments available-for-sale ⁽²⁾	6,351	—	—	6,351
Total	\$ 39,473	\$ 33,122	\$ —	\$ 6,351

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

(2) Investments available-for-sale consists of ARPS. ARPS are tax-exempt, long-term variable rate securities tied to short-term interest rates that are reset through a "Dutch Auction" process that occurs every seven days. The Company has the option to participate in the auction and sell ARPS to prospective buyers through a broker-dealer, but does not have the right to put the security back to the issuer. The investments in ARPS all had AAA credit ratings at the time of purchase and represent interests in collateralized debt obligations issued by municipal and state agencies. In the past, the auction process has allowed investors to obtain immediate liquidity if so desired by selling the securities at their face amounts. However, as has been recently reported in the financial press, the current disruptions in the credit markets have adversely affected the auction market for these types of securities. ARPS auctions "fail" when there are not enough buyers to absorb the amount of securities available for sale for that particular auction period. Historically, ARPS auctions have rarely failed since the investment banks and broker dealers have been willing to purchase the securities when investor demand was weak. However, beginning in mid-February 2008, due to uncertainty in the global credit and capital markets and other factors, investment banks and broker dealers have been less willing to support ARPS and many ARPS auctions have failed. The Company will not be able to access non-current investments until future auctions for these ARPS are successful, or until the Company sells the securities in a secondary market, which currently is not active, although there have been certain instances of redemptions at par by municipalities through the refinancing of new instruments.

As of September 30, 2008, the Company had invested \$6.5 million par value in ARPS, which are classified as available for sale non-current investments and reflected at fair value in the financial statements totaling \$6.4 million. As of September 30, 2008, \$1.3 million of investments in ARPS had been redeemed. The Company has included its investments related to ARPS in the Level 3 category.

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

As a result of the temporary declines in fair value for the Company's ARPS, which the Company attributes to liquidity issues rather than credit issues, it has recorded an unrealized loss of \$149,000 to accumulated other comprehensive income (loss). Due to the Company's belief that the market for these collateralized instruments may take in excess of twelve months to fully recover, the Company has classified these investments as non-current and has included them in investments on the unaudited condensed consolidated balance sheet at September 30, 2008. As of September 30, 2008, the Company continues to earn interest on all of its ARPS instruments. Any future fluctuation in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income (loss). If the Company determines that any future valuation adjustment was other than temporary, it would record a charge to earnings as appropriate. The Company is not certain how long it may be required to hold each security. However, given the Company's current cash position, liquid cash equivalents and expected cash flow from operations, it believes it has the ability to hold, and intends to continue to hold the failed ARPS as long-term investments until the market stabilizes.

The following table presents the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in SFAS 157 at September 30, 2008:

	Long-term Investments
	(in thousands)
Balance at December 31, 2007	\$ —
Transfers to Level 3	7,750
Redemption	(1,250)
Unrealized losses recorded to other comprehensive income	(149)
Balance at September 30, 2008	<u>\$ 6,351</u>

Non-Recurring Financial Assets

As of September 30, 2008, the Company held certain assets that are measured at fair value on a non-recurring basis. These included the Company's long-lived and indefinite lived intangible assets. The fair value of these non-financial assets was determined using the following inputs at June 30, 2008 and were not revalued to their fair value as of September 30, 2008:

	Total as of June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Losses)
	(in thousands)				
Intangible assets	<u>\$ 3,707</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,707</u>	<u>\$ (18,445)</u>

In accordance with the provisions of SFAS No. 144 (“SFAS 144”) “*Accounting for the Impairment or Disposal of Long-Lived Assets*”, intangible assets subject to amortization with a carrying value of \$19.9 million were written down to their fair value of \$2.2 million, resulting in an impairment charge of \$17.7 million during the quarter ended June 30, 2008, which was included in earnings for the period and is further described in Note 4 to the Company’s unaudited condensed consolidated financial statements included in this report.

In accordance with the provisions of SFAS 142 indefinite lived intangible assets with a carrying value of \$2.2 million were written down during the quarter ended June 30, 2008 to their fair value of \$1.5 million, resulting in an impairment charge of \$0.7 million, which was included in earnings for the period and is further described in Note 4 to the Company’s unaudited condensed consolidated financial statements included in this report.

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities*” (“SFAS 159”). SFAS 159 permits companies to choose to measure at fair value certain financial instruments and other items that are not currently required to be measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS 159 on January 1, 2008 and elected not to measure any additional financial instruments or other items at fair value.

Note 3—Inventory

Inventories consist of finished goods available-for-sale and are stated at the lower of cost or market value, determined using the first in, first out (“FIFO”) method. The Company purchases inventory from suppliers both domestically and internationally. The Company believes that its inventoried products are generally available from more than one supplier and seeks to maintain multiple sources for its products, both internationally and domestically.

The Company primarily purchases products in bulk quantities to take advantage of quantity discounts and to improve inventory availability. Inventory is reported net of inventory reserves for excess or obsolete products, which are established based on specific identification of slow moving items and the evaluation of overstock considering anticipated sales levels. Gross inventory, inventory reserves and net inventory at September 30, 2008 and December 31, 2007 are as follows:

	September 30, 2008 (unaudited)	December 31, 2007
	(in thousands)	
Gross inventory	\$ 13,180	\$ 11,794
Inventory reserves	(1,075)	(603)
Total net inventory	<u>\$ 12,105</u>	<u>\$ 11,191</u>

Note 4—Intangibles

Intangibles subject to amortization are expensed on a straight-line basis. Amortization expense relating to intangibles totaled \$4.6 million for the nine months ended September 30, 2008 and 2007. Assembled workforce included in the intangible assets was decreased by \$174,000 and increased by \$159,000 due to foreign currency fluctuations as of September 30, 2008 and December 31, 2007, respectively.

During the quarter ended June 30, 2008, the Company recorded, in accordance with SFAS 144, a non-cash impairment charge totaling \$18.4 million related to the intangibles associated with the Partsbin business, which the Company acquired in May 2006. The impairment was comprised of \$16.7 million for its websites; \$0.1 million for software; \$0.9 million for vendor agreements; and \$0.7 million for domain names. The interim impairment charge was primarily the result of: (i) the recent deterioration in the economic environment and the Company’s stock price, (ii) lower sales and profitability which generated losses from certain Partsbin websites, (iii) deficiencies in the software platform also acquired from Partsbin, and (iv) the termination of volume discounts and marketing co-ops from certain vendor agreements. Given the indicators of impairment and the excess of carrying value over the undiscounted cash flows associated with these intangibles, the Company utilized a discounted cash flow approach in determining fair value for both the websites and vendor agreement intangible assets. The decrease in future cash flows from certain acquired websites and vendor agreements resulted in the long-lived assets being impaired, as the carrying value of the website assets and vendor agreement assets exceeded the fair value of those assets. Fair value is determined as the net present value of future projected cash flows. The software and domain name assets’ fair value was determined using a relief from royalty approach which also resulted in a lower fair value than the carrying value. The intangible assets listed below as of September 30, 2008 represent the adjusted basis after the impairment loss.

During the quarter ended September 30, 2008, the Company acquired certain websites and domain names for a purchase price of \$415,000, of which \$386,000 was allocated to amortizable intangibles. The intangible assets were valued using a discounted cash flow model and the estimated useful life of the amortizable assets was determined to be five years.

Intangibles, excluding goodwill, consisted of the following at September 30, 2008 and December 31, 2007:

Useful Life	September 30, 2008 (unaudited)			December 31, 2007			
	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount	
(in thousands)							
Intangible assets subject to amortization:							
Websites	5 years	\$ 386	\$ —	\$ 386	\$ 28,988	\$ (9,367)	\$ 19,621
Software	2 - 5 years	1,040	(318)	722	4,089	(2,202)	1,887
Vendor agreements	3 years	—	—	—	2,996	(1,613)	1,383
Assembled workforce	7 years	1,271	(272)	999	1,446	(155)	1,291
Purchased domain names	3 years	175	(157)	18	175	(143)	32
Subtotal		2,872	(747)	2,125	37,694	(13,480)	24,214
Intangible assets not subject to amortization:							
Domain names	indefinite life	1,585	—	1,585	2,230	—	2,230
Total		<u>\$ 4,457</u>	<u>\$ (747)</u>	<u>\$ 3,710</u>	<u>\$ 39,924</u>	<u>\$ (13,480)</u>	<u>\$ 26,444</u>

Note 5—Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the potential loss, if any, cannot be reasonably estimated. However, the Company believes that the final disposition of such matters will not have a material adverse effect on the financial position, results of operations or cash flow of the Company with the exception of the items noted below. The Company maintains liability insurance coverage to protect the Company's assets from losses arising out of or involving activities associated with ongoing and normal business operations.

Ford Global Technologies, LLC

On December 2, 2005, Ford Global Technologies, LLC ("Ford") filed a complaint, subsequently amended, with the United States International Trade Commission ("USITC") against the Company and five other named Respondents, including four Taiwan-based manufacturers, contending that the Company and the other Respondents infringed 14 design patents that Ford alleged cover eight parts on the 2004-2005 Ford F-150 truck (the "Ford Design Patents"). Ford asked the USITC to issue a permanent general exclusion order excluding from entry into the United States all automotive parts that infringe the Ford Design Patents and that are imported into the United States, sold for importation in the United States, or sold within the United States after importation. Ford also sought a permanent order directing the Company and the other Respondents to cease and desist from, among other things, selling, marketing, advertising, distributing and offering for sale imported automotive parts that infringe the Ford Design Patents.

On June 6, 2007, the USITC issued its Notice of Final Determination. The Notice of Final Determination denied Respondent's petition for reconsideration and their motion for leave to supplement their petition. In addition, the USITC issued a general exclusion order prohibiting the importation of certain automotive parts found to infringe the seven Ford design patents found valid. The USITC's decision became final on August 6, 2007. On May 18, 2007, Ford filed a Notice of Appeal with the United States Federal Circuit Court of Appeals with regard to the three patents declared invalid in the ALJ's Initial Determination. On August 23, 2007, the Respondents filed a Notice of Appeal with the United States Federal Court of Appeals for the federal circuit. The appeals were consolidated. On October 17, 2008, the parties finished briefing the appeal. The federal circuit will likely hear oral arguments from the parties during the first quarter of 2009.

The Company will continue to defend this action vigorously. At the time the exclusion order was issued, the parts that are subject to the order comprised only a minimal amount of the Company's sales. However, as such parts become incorporated into more vehicles over time; it is likely that the amount of the Company's sales of such parts could have increased substantially. If the ten design patents in question are ultimately found on appeal to be valid and infringed, it is not anticipated that the loss of sales of these parts will be materially adverse to the Company's financial condition, cash flows or results of operations. However, depending upon the nature and extent of any adverse ruling, other auto manufacturers may attempt to assert similar allegations based upon design patents on a significant number of parts for several of their models, which over time could have a material adverse impact on the entire aftermarket parts industry.

On May 2, 2008, Ford filed with the USITC another complaint under Section 337 of the Tariff Act of 1930. The complaint alleges that the Company and seven other domestic and foreign entities import and sell certain automotive parts relating to the 2005 Ford Mustang that infringes eight Ford design patents. The USITC voted to institute an investigation, notice of which was published in the *Federal Register* on June 5, 2008. The Company has obtained extensions of its response date to Ford's complaint because the parties have been negotiating settlement. The Company expects settlement to be completed during the first half of 2009.

Securities Litigation

On March 24, 2007, a putative stockholder class action lawsuit was filed against the Company and certain officers, directors and underwriters in the U.S. District Court for the Central District of California. The complaint alleged that the Company filed a false Registration Statement in connection with the Company's initial public offering in violation of Section 11 and Section 15 of the Securities Act of 1933, as amended (the "Securities Act"). On April 26, 2007, a second complaint containing substantially similar allegations was filed, and also included a claim under Section 12(a)(2) of the Securities Act. The complaints were consolidated on May 15, 2007. A lead plaintiff was selected on August 9, 2007. The amended consolidated complaint was filed on October 4, 2007, alleging violations of Sections 11, 12(a)(2) and 15 of the Securities Act. The amended complaint was against the Company and certain current and former officers, as well as Oak Investment Partners XI, LP, and the underwriters involved in the initial public offering. The amended consolidated complaint alleged that the Company's Registration Statement failed to disclose material information and misstated the Company's financial results. Plaintiffs sought compensatory damages, restitution, unspecified equitable relief, as well as attorneys' fees and costs. In January 2008, the parties reached a settlement in principle. A definitive settlement agreement was filed on May 1, 2008, which settlement was preliminarily approved by the Court on June 13, 2008. The Company's contribution to the settlement consideration of approximately \$3.4 million plus legal expenses has been accrued in the Company's financial statements as of December 31, 2007. The settlement consideration was funded in July 2008 to an escrow account. On October 15, 2008, the United States District Court Judge for the Central District of California issued a final order and judgment approving the settlement and dismissing the case with prejudice.

In August 2007, the Company also received a letter from the SEC that indicated that the SEC had commenced an informal inquiry into the events leading up to the Company's announcement on March 20, 2007 of its financial results for the fourth quarter and year ended December 31, 2006. On October 30, 2008, the Company received correspondence from the SEC concluding the inquiry and recommending no enforcement action.

Note 6—Comprehensive Income

The Company reports comprehensive income in accordance with SFAS No. 130, "*Reporting Comprehensive Income*," which defines comprehensive income as net income affected by non-stockholder changes in equity. Comprehensive income (loss) for the three and nine months ended September 30, 2008 and 2007, respectively, includes the following:

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2008	2007	2008	2007
	(in thousands)			
Net income (loss)	\$ (491)	\$ 894	\$ (13,429)	\$ 1,901
Foreign currency translation adjustments	(81)	67	(235)	97
Unrealized loss in investments	—	—	(149)	—
Comprehensive income (loss)	<u>\$ (572)</u>	<u>\$ 961</u>	<u>\$ (13,813)</u>	<u>\$ 1,998</u>

Note 7—Reserve For Sales Returns

Sales discounts are recorded in the period in which the related sale is recognized. Credits are issued to customers for returned products which totaled \$15.6 million for the nine months ended September 30, 2008. The Company's sales returns and allowances reserve totaled \$669,000 and \$710,000 at September 30, 2008 and December 31, 2007, respectively.

The following table provides an analysis of the reserve for the Company's sales returns:

	<u>Balance at Beginning of Period</u>	<u>Charged to Revenue</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
	(in thousands)			
Reserve for sales returns:				
Nine months ended September 30, 2008	\$ 710	\$ 15,575	\$ (15,616)	\$ 669

Note 8—Income Taxes

For the three and nine months ended September 30, 2008, the effective tax rate for the Company was 42.4% and 40.0%, respectively. For the three and nine months ended September 30, 2007, the effective tax rate for the Company was 41.5% and 40.8%, respectively. The company's effective tax rate is higher than the U.S. federal statutory rate primarily as a result of state income taxes and other non-deductible permanent differences.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" ("FIN 48"), which became effective for the Company on January 1, 2007. FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. As a result of the implementation of FIN 48, the Company recognized no material adjustment in the liability for unrecognized income tax benefits.

As of September 30, 2008, the Company had no material unrecognized tax benefits, interest or penalties related to various federal and state income tax matters. The Company's policy is to recognize accrued interest and penalties related to unrecognized tax benefits as income tax expense.

The Company is subject to U.S. federal income tax, as well as income tax of foreign and state tax jurisdictions. The Company is currently under audit by the Internal Revenue Service for the year ended December 31, 2006. The Company is currently open to audit under the statute of limitations for the years ending December 31, 2003 through 2007.

Note 9—Net Income (Loss) Per Share

Net income (loss) per share has been computed in accordance with SFAS 128. The following table sets forth the computation of basic and diluted net income (loss) per share:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(in thousands, except share and per share data)			
Net Income (Loss) Per Share				
Numerator:				
Net income (loss)	\$ (491)	\$ 894	\$ (13,429)	\$ 1,901
Denominator:				
Weighted-average common shares outstanding (basic)	29,846,757	29,837,538	29,876,757	27,744,016
Common equivalent shares from conversion of preferred stock	—	—	—	947,608
Common equivalent shares from common stock options and warrants	—	172,353	—	57,897
Weighted-average common shares outstanding (diluted)	<u>29,846,757</u>	<u>30,009,891</u>	<u>29,846,757</u>	<u>28,749,521</u>
Basic and diluted net income (loss) per share	\$ (0.02)	\$ 0.03	\$ (0.45)	\$ 0.07

Note 10—Share-Based Compensation

The Company accounts for share-based compensation expense in accordance with SFAS No. 123 (revised 2004), “*Share-Based Payment*” (“SFAS 123(R)”), which was adopted on January 1, 2006. No stock options were granted prior to January 1, 2006. All stock options issued to employees are recognized as share-based compensation expense in the financial statements based on their respective grant date fair values, and are recognized within the statement of operations as general and administrative, marketing, fulfillment or technology expense, based on employee departmental classifications.

Under SFAS 123(R), the fair value of each share-based payment award is estimated on the date of grant using an option pricing model that meets certain requirements. The Company currently uses the Black-Scholes option pricing model to estimate the fair value of share-based payment awards, with the exception of options granted containing market conditions, which the Company estimates the fair value using a Monte-Carlo model. The determination of the fair value of share-based payment awards utilizing the Black-Scholes and Monte-Carlo models is affected by the Company’s stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. As of September 30, 2008, the Company did not have an adequate history of market prices of its common stock as the Company only recently became a public company in February 2007, and as such, the Company estimates volatility in accordance with Staff Accounting Bulletin No. 107 (“SAB 107”) using historical volatilities of similar public entities. The expected life of the awards is based on a simplified method which defines the life as the average of the contractual term of the options and the weighted average vesting period for all open tranches. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of awards. The dividend yield assumption is based on the Company’s expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

For non-employees, the Company accounts for share-based compensation in accordance with Emerging Issues Task Force No. 96-18, “*Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.*” Equity instruments awarded to non-employees are periodically remeasured as the underlying awards vest unless the instruments are fully vested, immediately exercisable and non-forfeitable on the date of grant.

Under SFAS 123(R), forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Our estimated forfeiture rate was calculated based on actual historical forfeitures experienced under our equity plans. In the third quarter of fiscal 2008, the Company performed its periodic review of the estimated forfeiture rate and based on turnover during the last twelve months, adjusted the weighted-average forfeiture rate from 5% to 16.7%. This change in estimated forfeiture rate was not material to the third quarter of 2008 but did result in a decrease of approximately \$2.9 million in share-based compensation expense for the remaining weighted-average period. As of September 30, 2008, there was \$7.1 million of unrecognized compensation expense related to stock options, which expense is expected to be recognized over a weighted-average period of 2.7 years.

The Company granted options to purchase up to 2,013,000 shares of its common stock under the Company’s 2007 Omnibus Incentive Plan (the “Plan”) at a weighted-average exercise price of \$3.63 per share during the nine months ended September 30, 2008. The intrinsic value of stock options at the date of exercise is the difference between the fair value of the stock at the date of exercise and the exercise price. During the three and nine months ended September 30, 2008, there were no option exercises under the Plan. Aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the fair value price of the Company’s common stock for options that were in-the-money as of September 30, 2008. No options outstanding at September 30, 2008 were in-the-money.

Note 11—Line of Credit

At September 30, 2008, the Company had no balance outstanding under its bank line of credit, which expires on October 31, 2009. The credit agreement contains customary covenants that, among other things, require compliance with certain financial ratios and targets and restrict the incurrence of additional indebtedness. As of September 30, 2008, the Company was in violation of its minimum EBITDA requirement; however, it has received a waiver from the lender.

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

Cautionary Statement

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this Report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission, or SEC, including our Annual Report on Form 10-K for the year ended December 31, 2007 and subsequent reports on Forms 10-Q and 8-K, which discuss our business in greater detail. The section entitled "Risk Factors" set forth below, and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition. You should carefully consider those risks, in addition to the other information in this Report and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.

Overview

We are a leading online provider of aftermarket auto parts, including body parts, engine parts and performance parts and accessories. Our user-friendly websites provide customers with a broad selection of automotive parts, with detailed product descriptions and photographs. Our proprietary product database maps our SKUs to product applications based on vehicle makes, models and years. We principally sell our products to individual consumers through our network of websites and online marketplaces. Our flagship websites are located at www.partstrain.com and www.autopartswarehouse.com. We believe our strategy of disintermediating the traditional auto parts supply channels and selling products directly to customers over the Internet allows us to more efficiently deliver products to our customers while generating higher margins.

Our History. We were formed in 1995 as a distributor of aftermarket auto parts and launched our first website in 2000. We rapidly expanded our online operations, increasing the number of SKUs sold through our e-commerce network, adding additional websites, improving our Internet marketing proficiency and commencing sales in online marketplaces. As a result, our business has grown significantly since 2000, generating net sales of \$161.0 million for the year ended December 31, 2007.

Partsbin Acquisition. In May 2006, we completed the acquisition of Partsbin. As a result of this acquisition, we expanded our product offering and product catalog to include performance parts and accessories and additional engine parts, enhanced our ability to reach more customers, significantly increased our net sales and added a complementary, drop-ship order fulfillment method. Partsbin also expanded our international operations by adding a call center in the Philippines and an outsourced call center in India, as well as a Canadian subsidiary to facilitate sales in Canada. We also augmented our technology platform and expanded our management team. We may pursue additional acquisition opportunities in the future to increase our share of the aftermarket auto parts market or expand our product offerings.

International Operations. Since 2003, we have maintained operations in the Philippines. As our ability to manage offshore operations has improved, we have increased our offshore capacity. In the Philippines, we operate a call center, information systems, application and web development, category management, and internet marketing, all supported by Philippine-based accounting and human resources. In addition to our Philippines operations, we have outsourced call center operations in India and own a Canadian subsidiary to facilitate sales of our products in Canada. We believe that the cost advantages of our offshore operations provide us with the ability to grow our business in a cost-effective manner, and we expect to continue to add headcount and infrastructure to our offshore operations.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, intangible and other long-lived assets and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. There were no significant changes to our critical accounting policies during the three and nine months ended September 30, 2008, as compared to those policies disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2007 except as noted below.

In September 2006, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 157, “*Fair Value Measurements*” (“SFAS 157”) which defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. We have adopted the provisions of SFAS 157 as of January 1, 2008 for financial assets. SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1-defined as observable inputs such as quoted prices in active markets; Level 2-defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3-defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. We have evaluated both Level 2 and Level 3 evidence to measure the fair value of our \$6.5 million of auction rate preferred securities (“ARPS”) as of September 30, 2008. These investments consist solely of collateralized debt obligations supported by municipal and state agencies; do not include mortgage-backed securities or student loans; have redemption features that call for redemption at 100% of par value; and have a current credit rating of A or AAA. As of September 30, 2008, we received partial redemptions at par on our investments totaling \$1.3 million. The fact that there is not an active market as of September 30, 2008 to liquidate 100% of these certain investments was the final determination in classifying them as Level 3. We used a discounted cash flow valuation model to estimate the fair value of the securities. As a result of the temporary declines in fair value of our ARPS, which we attribute to liquidity issues rather than credit issues, we have recorded an unrealized loss of \$149,000 to accumulated other comprehensive income (loss).

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities*” (“SFAS 159”). SFAS 159 permits companies to choose to measure at fair value certain financial instruments and other items that are not currently required to be measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We adopted SFAS 159 on January 1, 2008 and elected not to measure any additional financial instruments or other items at fair value.

In accordance with SFAS No. 142, “*Goodwill and Intangible Assets*” (“SFAS 142”) and SFAS No. 144, “*Accounting for the Impairment or Disposal of Long-Lived Assets*” (“SFAS 144”), we recorded an impairment charge totaling \$18.4 million in the quarter ended June 30, 2008 on intangible assets associated with the Partsbin business, which we acquired in May 2006. The impairment charge related to its websites, software, vendor agreements and domain name intangible assets. The interim impairment charge was primarily the result of: (i) the recent deterioration in the economic environment and the Company’s stock price, (ii) lower sales and profitability which generated losses from certain Partsbin websites, (iii) deficiencies in the software platform also acquired from Partsbin, and (iv) the termination of volume discounts and marketing co-ops from certain vendor agreements. Given the indicators of impairment and the excess of the carrying value over the undiscounted cash flows associated with these intangibles, we utilized a discounted cash flow approach in determining fair value for both the websites and vendor agreement intangible assets. The decrease in future cash flows from certain acquired websites and vendor agreements resulted in the long-lived assets being impaired, as the carrying value of the website assets and vendor agreement assets exceeded the fair value of those assets determined as the net present value of future projected cash flows. The software and domain name assets’ fair value was determined using a relief from royalty approach, which also resulted in a lower fair value than the carrying value of the assets.

Results of Operations

The following table sets forth certain unaudited statements of operations data as a % of net sales for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	67.0	63.8	66.2	66.7
Gross profit	33.0	36.2	33.8	33.3
Operating expenses:				
General and administrative	11.4	8.4	11.2	7.9
Marketing	14.3	13.0	14.9	12.7
Fulfillment	6.4	5.1	5.7	4.4
Technology	2.8	1.2	2.1	1.1
Amortization of intangibles	1.0	5.5	19.2	5.1
Total operating expenses	35.9	33.2	53.1	31.2
Income (loss) from operations	(2.9)	3.0	(19.3)	2.1
Other income:				
Other income (loss)	(0.1)	0.0	0.0	0.0
Interest income, net	0.7	1.0	0.6	0.5
Total other income	0.6	1.0	0.6	0.5
Income (loss) before income taxes	(2.3)	4.0	(18.7)	2.6
Income tax provision (benefit)	(1.0)	1.6	(7.5)	1.1
Net income (loss)	(1.3) %	2.4%	(11.2) %	1.5%

Three and Nine Months Ended September 30, 2008 Compared to Three and Nine Months Ended September 30, 2007

Net Sales and Gross Margin

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Net sales	\$ 36,554	\$ 37,787	\$ 119,668	\$ 123,642
Cost of sales	24,485	24,096	79,262	82,497
Gross profit	\$ 12,069	\$ 13,691	\$ 40,406	\$ 41,145
Gross margin	33.0%	36.2%	33.8%	33.3%

Net sales decreased 3.3% to \$36.6 million and decreased 3.2% to \$119.7 million for the three and nine months ended September 30, 2008, respectively, compared to the same periods in the previous year. The three month year-over-year decrease was primarily due to a \$1.0 million or 26.6% decrease in our offline business, which consists of our Kool Vue and wholesale operations. The nine month year-over-year decrease was due to 2.4% decrease in our online business and a 10.8% decrease in our offline business. Our online business consists of two sales channels, e-commerce and online marketplaces. Our e-commerce channel includes a network of e-commerce websites supported by our call-center sales agents who generate cross-sell and up-sell opportunities. Our online marketplaces consist primarily of auction and other third-party websites.

E-commerce sales decreased 3.2% to \$28.6 million for the three months ended September 30, 2008 from \$29.5 million for the prior year period. This decrease is primarily due to a decline of 6,000 placed orders in our e-commerce channel over the prior-year period and a \$6 decrease in our average order value to \$121 for the third quarter of 2008 from \$127 in the third quarter of 2007. For the nine months ended September 30, 2008 and 2007, e-commerce sales were \$92.9 million and \$95.4 million, respectively. The 2.6% decrease was primarily due to a \$4 decrease in average order value compared to the prior-year period.

Online marketplaces sales increased 14.5% to \$5.3 million for the three months ended September 30, 2008 from \$4.6 million for the same period in the prior year. This increase was primarily due to increased sales on our auction platform. For the nine months ended September 30, 2008 and 2007, online marketplaces sales were \$16.2 million and \$16.4 million, respectively.

Net sales from our offline business decreased 26.6% to \$2.7 million and 10.8% to \$10.6 million for the three and nine months ended September 30, 2008, compared to the same periods in the prior year. This decrease in net sales is primarily due to reduced purchases from a significant customer in the second and third quarters of 2008. We anticipate that sales from our wholesale operations will continue to decline as a percentage of net sales in the future.

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

Gross profit was \$12.1 million or 33.0% of net sales and \$40.4 million or 33.8% of net sales for the three and nine months ended September 30, 2008, compared to \$13.7 million or 36.2% of net sales and \$41.1 million or 33.3% of net sales in the same periods in the prior year. The decrease of 3.2% in gross margins for the three months ended September 30, 2008 compared to the same period in the prior year was primarily due to higher fuel costs and third party shipping costs, higher raw material costs, and lower vendor rebates. The 0.5% increase in gross margins for the nine months ended September 30, 2008 compared to the same periods in the prior year was primarily due to a mix-shift to in stock distribution, partially offset by higher outbound freight costs.

General and Administrative Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
General and administrative expense	\$ 4,170	\$ 3,184	\$ 13,381	\$ 9,715
Percent of net sales	11.4%	8.4%	11.2%	7.9%

General and administrative expense increased \$1.0 million or 31.0% and \$3.7 million or 37.7% for the three and nine months ended September 30, 2008, from the same periods in the previous year. The increase for the three months ended September 30, 2008 primarily reflects \$400,000 higher payroll related costs; \$300,000 of increased amortization expense; a \$200,000 increase in share-based compensation expense; and \$100,000 of additional professional fees. The increase for the nine months ended September 30, 2008 primarily reflects \$1.5 million higher payroll costs; \$800,000 of increased professional fees and public company operating expenses; \$800,000 of higher amortization expense; and \$300,000 of increased share-based compensation expense.

During the three and nine months ended September 30, 2008, we recognized \$800,000 and \$2.1 million, respectively, of share-based compensation, determined in accordance with SFAS 123(R). Based on options outstanding as of September 30, 2008, we expect to recognize \$7.1 million in additional share-based compensation expense over a weighted average period of 2.7 years.

Marketing Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Marketing expense	\$ 5,240	\$ 4,917	\$ 17,842	\$ 15,738
Percent of net sales	14.3%	13.0%	14.9%	12.7%

Marketing expense increased \$300,000 or 6.6% and \$2.1 million or 13.4% for the three and nine months ended September 30, 2008, from the same periods in the previous year. As a percentage of net sales, marketing expense increased 1.3% to 14.3% for the three months ended September 30, 2008 compared to the prior-year period primarily due to higher depreciation expense related to the expansion of our offshore facilities. As a percentage of net sales, marketing expense increased 2.2% to 14.9% for the nine months ended September 30, 2008 compared to the prior-year period primarily due to \$1.3 million of increased personnel costs in our offshore operations; partially offset by the elimination of our U.S. based call center costs; and \$600,000 of higher depreciation expense.

Fulfillment Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Fulfillment expense	\$ 2,322	\$ 1,920	\$ 6,787	\$ 5,499
Percent of net sales	6.4%	5.1%	5.7%	4.4%

Fulfillment expense increased \$400,000 or 20.9% and \$1.3 million or 23.4% for the three and nine months ended September 30, 2008, from the same periods in the previous year. As a percentage of net sales, fulfillment expense increased 1.3% to 6.4% for the three months ended September 30, 2008 compared to the prior-year period primarily due to \$100,000 of additional payroll related costs; a \$200,000 increase in our fulfillment center costs; and \$100,000 higher depreciation expense. As a percentage of net sales, fulfillment expense increased 1.3% to 5.7% for the nine months ended September 30, 2008 compared to the prior-year period primarily due to \$600,000 in payroll costs; a \$300,000 increase in our fulfillment center costs; and \$400,000 of higher depreciation expense.

Technology Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Technology expense	\$ 1,041	\$ 438	\$ 2,512	\$ 1,394
Percent of net sales	2.8%	1.2%	2.1%	1.1%

Technology expense increased 137.7% to \$1.0 million and increased 80.2% to \$2.5 million for the three and nine months ended September 30, 2008, respectively. The increase in both periods was due to increased investments in our technology platform with increased headcount and third-party service providers.

Amortization of Intangibles and Impairment Loss

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Amortization of intangibles and impairment loss	\$ 365	\$ 2,097	\$ 23,005	\$ 6,251
Percent of net sales	1.0%	5.5%	19.2%	5.1%

Amortization of intangibles and impairment loss decreased \$1.7 million or 82.6% for the three months ended September 30, 2008 and increased by \$16.8 million to \$23.0 million for the nine months ended September 30, 2008. The decrease for the three months ended September 30, 2008 was primarily due to lower pre-tax income from the prior year period. The increase for the nine months ended September 30, 2008 was primarily due to a non-cash impairment charge in the second quarter of 2008 totaling \$18.4 million on intangible assets associated with the Partsbin business, which we acquired in May 2006. For further discussion, refer to our SFAS 144 disclosure in the Critical Accounting Policies section. We estimate aggregate amortization expense for the remaining three months ending December 31, 2008, and the years ending December 31, 2009, 2010, 2011 and thereafter to be approximately \$400,000, \$700,000, \$300,000, \$300,000 and \$400,000, respectively.

Other Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Other income	\$ 216	\$ 392	\$ 724	\$ 662
Percent of net sales	0.6%	1.0%	0.6%	0.5%

The decrease in other income during the three months ended September 30, 2008 was primarily due to \$200,000 lower interest income related to lower interest rates in the third quarter of 2008 compared to the prior year period. The increase in other income during the nine months ended September 30, 2008 compared to the prior-year period was primarily due to interest income generated from investing the IPO proceeds, which was partially offset by a \$600,000 reduction of interest expense due to the repayment of approximately \$28.0 million of our long-term indebtedness upon completion of our initial public offering in February 2007.

Income Tax Provision (Benefit)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Income tax provision (benefit)	\$ (362)	\$ 633	\$ (8,968)	\$ 1,309
Percent of net sales	(1.0%)	1.6%	(7.5%)	1.1

The decrease in income tax provision (benefit) during the three and nine months ended September 30, 2008 was primarily due to the tax effect of the \$18.4 million impairment loss on our intangible assets. This is a temporary timing difference as we expect to reduce our cash paid for taxes over the remaining asset life of twelve years for tax purposes.

Liquidity and Capital Resources

Sources of Liquidity

We have historically funded our operations from cash generated from operations, credit facilities, bank loans, equity financings and capital lease financings. At September 30, 2008, we had no balance outstanding under our bank line of credit, which expires on October 31, 2009. The credit agreement contains customary covenants that, among other things, require compliance with certain financial ratios and targets and restrict the incurrence of additional indebtedness. As of September 30, 2008, we were in violation of our minimum EBITDA requirement; however, we have received a waiver from our lender.

Cash Flows

We had cash and cash equivalents of \$33.1 million as of September 30, 2008, representing a \$9.0 million decrease from \$42.1 million of liquid assets as of December 31, 2007. The decrease in our cash and cash equivalents as of September 30, 2008 was primarily due to a reclassification of \$6.4 million of our investments in ARPS to long-term and a \$3.4 million payment related to our securities litigation settlement in July 2008.

Operating Activities

We generated \$1.9 million of net cash from operating activities for the nine months ended September 30, 2008. The significant components of cash flows from operating activities were a net loss of \$13.4 million; an increase of \$8.9 million in deferred tax assets primarily related to the tax benefit from the impairment loss on our intangibles; an increase of \$0.9 million to our inventory; a \$2.6 million net change in other current assets and liabilities, which primarily relates to the \$3.4 million settlement in our securities class action litigation; offset by \$7.2 million in non-cash depreciation and amortization expense; \$18.4 million of a non-cash impairment loss on intangibles; and \$2.1 million of non-cash stock-based compensation expense.

Investing Activities

Cash provided by investing activities during the nine months ended September 30, 2008 totaled \$12.8 million and was primarily attributable to our net change in investments of \$16.2 million in ARPS and purchases of \$2.9 million of property and equipment.

Financing Activities

Cash used in financing activities during the nine months ended September 30, 2008 totaled \$1.0 million and was primarily due to repayments made on notes payable.

Funding Requirements

We had working capital of \$36.1 million as of September 30, 2008, which was primarily due to the cash generated from our initial public offering. The historical seasonality in our business during the first and fourth calendar quarters of each year cause cash and cash equivalents, inventory and accounts payable to be generally higher in these quarters, resulting in seasonal fluctuations in our working capital. We anticipate that funds generated from operations, and cash on hand will be sufficient to meet our working capital needs and expected capital expenditures for at least the next twelve months. Our future capital requirements may, however, vary materially from those now planned or anticipated. Changes in our operating plans, lower than anticipated net sales, increased expenses or other events, including those described in "Risk Factors," may cause us to seek additional debt or equity financings in the future. Financing may not be available on acceptable terms, on a timely basis, or at all, and our failure to raise adequate capital when needed could negatively impact our growth plans and our financial condition and results of operations. In addition, our \$6.4 million of ARPS investments as of September 30, 2008 were classified as long-term investments as a result of failed auctions and liquidity issues and we may not have access to those funds.

We are currently planning on opening a new distribution center on the east coast which would result in a significant capital investment. We expect to incur approximately \$2.0 million in facility start-up costs which includes a new warehouse technology platform and up to an additional \$3.0 million in inventory. We are also accelerating our technology investments in an effort to improve our websites, operating systems and backend platforms. We anticipate these decisions will increase our technology costs as a percentage of sales as well as increase our capitalized software and website development costs over the next several quarters.

Seasonality

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

Inflation

Inflation has not had a material impact upon our operating results to date, 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. We have experienced gross margin pressure from rising fuel costs, steel costs, and other component material.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

We do not use financial instruments for trading purposes, and do not hold any derivative financial instruments that could expose us to significant market risk. Our primary market risk exposure with regard to financial instruments is changes in interest rates. We also have some risk related to foreign currency fluctuations.

Interest Rate Risk. All of our investments are classified as available-for-sale and therefore reported on the balance sheet at market value. Our investment securities consist of high-grade ARPS. As of September 30, 2008, our long-term investments included \$6.4 million of investments in ARPS, which consist of high-grade (A or AAA rated) collateralized debt obligations issued by municipal and state agencies. Our ARPS have an interest rate that is reset in short intervals through auctions. The recent conditions in the global credit markets have prevented some investors from liquidating their holdings of ARPS because the amount of securities submitted for sale has exceeded the amount of purchase orders for these securities. If there is insufficient demand for the securities at the time of an auction, the auction may not be completed and the interest rates may be reset to predetermined higher rates. When auctions for these securities fail, the investments may not be readily convertible to cash until a future auction of these investments is successful or they are redeemed or mature. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an impairment charge.

On February 13, 2008, we were informed that there was insufficient demand at auctions for four of our high-grade ARPS, representing approximately \$7.8 million. As a result, these affected securities are currently not liquid and the interest rates have been reset to the predetermined higher rates. As of September 30, 2008, we received partial redemptions at par on all four ARPS totaling \$1.3 million with a remaining principal balance on our ARPS of \$6.5 million.

In the event we need to access the funds that are in an illiquid state, we will not be able to do so without the possible loss of principal, until a future auction for these investments is successful or they are redeemed by the issuer. At this time, management has not obtained sufficient evidence to conclude that these investments are impaired or that they will not be settled in the short term, although the market for these investments is presently uncertain. If we are unable to sell these securities in the market or they are not redeemed, then we may be required to hold them indefinitely. We do not have a need to access these funds for operational purposes for the foreseeable future. We will continue to monitor and evaluate these investments on an ongoing basis for impairment or for a short-term to long-term reclassification. Based on our ability to access our cash and other short-term investments, our expected cash flows, and our other sources of cash, we do not anticipate that the potential illiquidity of these investments will affect our ability to execute our current business plan. However, due to the illiquidity of the market, we have recorded \$149,000 of unrealized losses on our investment portfolio as of September 30, 2008.

Pursuant to the terms of our line of credit with our principal lender, changes in the prime rate or monthly LIBOR rate could affect the rates at which we could borrow funds under our line of credit. At September 30, 2008, we had no outstanding borrowings under our line of credit with this lender.

Foreign Currency Risk. Our purchases of auto parts from our Asian suppliers are denominated in U.S. dollars and a change in the foreign currency exchange rates could impact our product costs over time. Our financial reporting currency is the U.S. Dollar and changes in exchange rates significantly affect our reported results and consolidated trends. For example, if the U.S. Dollar weakens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit, and operating expenses will be higher than if currencies had remained constant. Likewise, if the U.S. Dollar strengthens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit, and operating expenses will be lower than if currencies had remained constant. Our operating expenses in the Philippines are generally paid in Philippine Pesos and as the exchange rate fluctuates, it adversely or favorably impacts our operating results. In light of the above, we believe that a fluctuation of 10% in the Peso/U.S. Dollar exchange rate would have approximately a \$600,000 impact on our operating expenses for the nine months ended September 30, 2008. Our Canadian website sales are denominated in Canadian Dollars; however, fluctuations in exchange rates from these operations would have only a nominal impact on our operating results. We also believe it is important to evaluate our operating results and growth rates before and after the effect of currency changes.

ITEM 4. Controls and Procedures***Evaluation of Disclosure Controls and Procedures***

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

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

Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level because of the identification of certain material weaknesses in our internal control over financial reporting, as described in our 2007 Form 10-K, which we view as an integral part of our disclosures controls and procedures.

Changes in Internal Control Over Financial Reporting

During the most recent fiscal quarter, no change in our internal control over financial reporting has occurred that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

However, to address the identified material weakness, we are in the process of implementing remediation plans, including the following:

- We hired several key accounting and SOX professionals during the nine months ended September 30, 2008.
- We hired additional information technology management who are documenting and testing our information technology general controls.
- We are completing our documentation of policies and procedures, and are in the process of testing our key controls.

Inherent Limitations on Internal Controls

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

PART II. Other Information

ITEM 1. Legal Proceedings

The information set forth under Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report, is incorporated herein by reference.

ITEM 1A. Risk Factors

Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described below in addition to the other cautionary statements and risks described elsewhere, and the other information contained, in this report and in our other filings with the SEC, including our subsequent reports on Forms 10-K, 10-Q and 8-K, and any amendments thereto. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs with material adverse effects on us, our business, financial condition, results of operations and/or liquidity could be seriously harmed. In that event, the market price for our common stock will likely decline and you may lose all or part of your investment.

Risks Related To Our Business

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

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

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

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

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

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

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

As part of our growth strategy, we expect that we will selectively pursue acquisitions of businesses, technologies or services in order to expand our capabilities, enter new markets or increase our market share. Integrating any newly acquired businesses' websites, technologies or services is likely to be expensive and time consuming. For example, our acquisition of Partsbin has resulted in significant costs, including a material impairment charge, and a number of challenges, including retaining employees of the acquired company, integrating our order processing and credit processing, integrating our product pricing strategy, and integrating the diverse technologies and differing e-commerce platforms and accounting systems used by each company. If we are unable to successfully complete the integration of acquisitions, we may not realize the synergies from such acquisition, and our business and results of operations could suffer. To finance any future acquisitions, it may also be necessary for us to raise additional capital through public or private financings. Additional funds may not be available on terms that are favorable to us, and, in the case of equity financings, would result in dilution to our stockholders. Future acquisitions by us could also result in large and immediate write-offs, assumption of debt and unforeseen liabilities and significant adverse accounting charges, any of which could substantially harm our business, financial condition and results of operations.

Our integration of Partsbin has been time consuming and expensive, and may continue to negatively impact our business.

In May 2006, we completed the acquisition of Partsbin, an online retailer of aftermarket auto parts. As a result of the acquisition, we added 47 employees, and our available SKUs and net sales increased significantly. The acquisition of Partsbin has involved significant costs, has resulted in challenges integrating the diverse technologies used by each company and has placed, and may continue to place, pressures on our operational and financial infrastructure. We cannot assure you that our current cost structure or infrastructure will be adequate for the combined companies. We need to continue to improve our operational and financial systems, procedures and controls and maintain our cost structure at appropriate levels.

The Partsbin acquisition also expanded our product offerings, particularly in the area of engine parts and performance parts and accessories, and significantly increased our use of drop-ship as a method of fulfillment. We cannot assure you that we can effectively manage this new fulfillment model or address the market for these additional auto parts.

The integration of Partsbin has, and may continue to, involve the consolidation of diverse business cultures and technology infrastructures, require substantial time and expenses, and distract management from other business matters. In early 2007, we discovered some integration issues related to the Partsbin acquisition that were largely related to lower than expected order fill rates from drop-ship vendors in the fourth quarter of 2006 and lower pricing levels on our performance parts and accessories product category in the first quarter of 2007, which negatively impacted our gross margins during 2007. In addition, this acquisition included significant intangible assets that are subject to periodic impairment testing which in the second quarter of 2008 resulted in an impairment charge in the amount of the total intangible asset related to the acquisition. We cannot assure you that we will be able to adequately address these or other integration issues related to this acquisition.

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

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

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

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

We acquire substantially all of our products from manufacturers and distributors located in Taiwan, China and the United States. Our top ten suppliers represented approximately 60.6% of our total product purchases during the nine months ended September 30, 2008. 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. We continue to enter into supply agreements with our U.S. based suppliers and our primary drop-ship vendors. In addition, our ability to acquire products from our suppliers in amounts and on terms acceptable to us is dependent upon a number of factors that could affect our suppliers and which are beyond our control. For example, financial or operational difficulties that some of our suppliers may face could result in an increase in the cost of the products we purchase from them. In addition, the increasing consolidation among auto parts suppliers may disrupt or end our relationship with some suppliers, result in product shortages and/or could lead to less competition and, consequently, higher prices.

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

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

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

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

For a number of the products that we sell, we outsource the distribution and fulfillment operation and are dependent on our distributors to manage inventory, process orders and distribute those products to our customers in a timely manner. For the nine months ended September 30, 2008, our product purchases from a single supplier represented 14.7% or more of our total product purchases. If we do not maintain our existing relationships with our distributors on acceptable commercial terms, we will need to obtain other suppliers and may not be able to continue to offer a broad selection of merchandise at competitive prices, and our sales may decrease.

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

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

We rely on third parties for the shipment of our products and we cannot be sure that these relationships will continue on terms favorable to us, or at all. Shipping costs have increased from time to time, and may continue to increase, which could harm our business, prospects, financial condition and results of operations by increasing our costs of doing business and resulting in reduced gross margins. In addition, if our relationships with these third parties are terminated or impaired, or if these third parties are unable to deliver products for us, whether through 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 continue to increase, our margins may shrink.

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

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

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

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

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

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

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

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

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

- national auto parts retailers such as Advance Auto Parts, AutoZone, CSK Auto, Napa Auto Parts, O'Reilly Automotive and Pep Boys;
- large online marketplaces such as Amazon.com and eBay;
- online competitors;
- local independent retailers or niche auto parts online retailers; and
- wholesale auto parts distributors such as LKQ Corporation.

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

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

Our ability to sustain or increase our profitability will suffer if we fail to manage our growth effectively.

In recent years, we have experienced rapid growth that has placed, and may continue to place, pressures on our operational and financial infrastructure. Our workforce has increased from 114 employees as of December 31, 2003 to 824 employees as of September 30, 2008. Our net sales have increased from \$31.7 million in 2003 to \$161.0 million in 2007. Our recent expansion and planned growth have placed, and are expected to continue to place, a strain on our infrastructure, operations and managerial resources. We intend to further increase the size of our operations, and we expect our operating expenses to increase, as we, among other things:

- expand our domestic and international operations;
- add additional distribution facilities;
- increase our technology and development efforts to enhance and maintain our websites and technology infrastructure;
- hire additional personnel, including customer service specialists, sales and marketing professionals and financial professionals;
- upgrade our operational and financial systems, procedures and controls; and
- address the responsibilities and costs of being a public company, including costs of complying with the Sarbanes-Oxley Act of 2002.

Our success depends upon our ability to manage our operations and our growth effectively. To be successful, we will need to improve our operational and financial systems, procedures and controls, maintain our cost structure at appropriate levels, manage international operations, and hire additional personnel. We cannot assure you that our efforts will be successful or that we can improve our systems, procedures and controls in a timely manner. Delays or problems associated with any improvements or expansion of our systems, procedures and controls could harm our business and operating results. In addition, we may fail to accurately estimate and assess our increased operating expenses as we grow. As our operating expenses increase, we will need to grow our revenue in order to maintain our profitability.

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

Original equipment manufacturers have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEM’s 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 OEM’s or other third parties. For instance, in December 2005, Ford Global Technologies, LLC initiated a complaint with the International Trade Commission against six companies, including us, alleging that certain aftermarket parts imported into the United States infringed on 14 design patents held by Ford Global. Ford also sought a permanent order directing us and the other respondents to cease and desist from, among other things, selling, marketing, advertising, distributing and offering for sale imported auto parts that infringe the design patents. In December 2006, an administrative law judge of the International Trade Commission preliminarily ruled that seven of the Ford Global design patents were valid and that the importation of automotive parts covered by these seven patents violated Section 337 of the Tariff Act of 1930. The International Trade Commission affirmed the ruling of the administrative law judge and issued an order prohibiting further importation of automotive parts covered by the patents. The parties to the action have appealed the decision to the United States Circuit Court of Appeals for the Federal Circuit. On October 17, 2008, the parties finished briefing the appeal. The federal circuit will likely hear oral arguments from the parties during the first half of 2009.

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

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

We regard our trademarks, trade secrets and similar intellectual property 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, third parties may infringe or misappropriate our proprietary rights, and we could be required to incur significant expenses to preserve them. We have common law trademarks, as well as pending federal trademark registrations for several marks and one registered mark. Even if we obtain approval of such pending registrations, the resulting registrations may not adequately cover our inventions 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.partstrain.com and www.autopartswarehouse.com, and have invested time and money in the purchase of domain names and other intellectual property, which may be impaired if we cannot protect such intellectual property. We may be unable to protect these domain names or acquire or maintain relevant domain names in the United States and in other countries. If we are not able to protect our trademarks, domain names or other intellectual property, we may experience difficulties in achieving and maintaining brand recognition and customer loyalty.

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

We have invested significant resources and time to build and maintain our product catalog, which is maintained in the form of an electronic database, and 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 by a third party 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 by a competitor, 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. 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 theirs to any of the software that we use, we may be exposed to claims and liability for intellectual property infringement. A number of lawsuits are currently pending against third parties over the ownership rights to the various components within some open-source software that we use. If the outcome of these lawsuits is unfavorable, we may be held liable for intellectual property infringement based on our use of these open-source software components. We may also be forced to implement changes to the code-base for this software or replace this software with internally developed or commercially licensed software.

We face exposure to product liability lawsuits.

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

Capacity constraints on our technology infrastructure would harm our business, prospects, results of operations and financial condition.

If the volume of traffic on our websites or the number of purchases made by customers increases substantially, we may need to further expand and upgrade our technology, transaction processing systems and network infrastructure. Capacity constraints can cause unanticipated system disruptions, slower response times, degradation in levels of customer service, impaired quality and delays in reporting accurate financial information.

We may be unable to project accurately the rate or timing of traffic increases or successfully and cost-effectively upgrade our systems and infrastructure in time to accommodate future traffic levels on our websites. Any such upgrades to our systems and infrastructure will require substantial expenditures. In addition, we may be unable to upgrade and expand our transaction processing systems in an effective and timely manner or to integrate any newly developed or purchased functionality with our existing systems. Any inability to efficiently upgrade our systems and infrastructure in a timely manner to account for such growth and integrations may cause unanticipated system disruptions, slower response times, degradation in levels of customer service, impaired quality, delayed order fulfillment, any of which could result in a decline in our sales and harm our reputation.

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 key personnel including Shane Evangelist, our Chief Executive Officer, and Michael McClane, our Chief Financial Officer, Executive Vice President of Finance, Treasurer and Secretary. Messrs. Evangelist, and McClane, as well as any of our other key employees, can terminate their employment relationship with us at any time. We do not maintain key person life insurance on any officer or employee. Our performance also depends on our ability to identify, attract, retain and motivate highly skilled technical, managerial, merchandising, marketing and call center personnel. Competition for such personnel is intense, and we cannot assure you that we will be successful in attracting and retaining such personnel. The loss of any key employee or our inability to attract or retain other qualified employees could harm our business and results of operations.

Risks Related To Our Common Stock

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

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

Since the completion of our initial public offering in February 2007, the trading price of our common stock has been volatile, declining from a high of \$12.61 per share to a low per share of \$1.40. 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. In March 2007, we and certain of our officers, directors and the underwriters for our initial public offering were served with two putative class action complaints alleging violations of federal securities law in connection with our initial public offering. These complaints were subsequently consolidated. In January 2008, the parties to the litigation reached an agreement to settle in principle, subject to confirmatory discovery, finalization of settlement document and Court approval. If the settlement is not consummated, the litigation would continue. In October 2008, final court approval was obtained but is still subject to appeal. Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of the litigation if it were to continue. An unfavorable result could have a material adverse effect on our financial condition and results of operation.

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

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

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

As of September 30, 2008, our executive officers and directors and entities that are affiliated with them beneficially owned approximately 56.9% of our outstanding shares of common stock. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. Also, these stockholders, acting together, will be able to control our management and affairs and matters requiring stockholder approval including the election of our entire board of directors and certain significant corporate actions such as mergers, consolidations or the sale of substantially all of our assets. As a result, this concentration of ownership could delay, defer or prevent others from initiating a potential merger, takeover or other change in our control, even if these actions would benefit our other stockholders and us.

Our future operating results may fluctuate and may fail to meet market expectations, which could adversely affect the market price of our common stock.

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. In March 2007, our stock price decreased by approximately 45% following our announcement that our financial results for the quarter ended December 31, 2006 did not meet analysts' expectations. Since our initial public offering in February 2007, the sales price per share of our common stock has fluctuated between a high of \$12.61 and a low of \$1.40. The factors that could cause our operating results to continue to fluctuate include, but are not limited to:

- fluctuations in the demand for aftermarket auto parts;
- price competition on the Internet or among offline retailers for auto parts;
- our ability to attract visitors to our websites and convert those visitors into customers;
- our ability to maintain and expand our supplier and distribution relationships;
- 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;
- 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; and
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure.

Two class action lawsuits have been filed against us and certain of our officers and directors and there is an SEC informal inquiry into this matter, which has resulted and may continue to result in significant costs and a diversion of our management's efforts.

We and certain of our officers, directors and underwriters were served with two complaints associated with class action lawsuits alleging violations of federal securities law in connection with our initial public offering. In January 2008, we and the lead plaintiff's counsel reached a non-binding proposed settlement agreement under a memorandum of understanding ("MOU"), which outlines the general terms to be included in the binding agreement. We entered into a settlement agreement in this regard in May 2008, and the court approved the settlement in October 2008. A settlement payment of \$10.0 million will be paid to the lead plaintiff's counsel within thirty days of a court-approved settlement. We funded the settlement consideration in July 2008 to an escrow account which will be disbursed after the 30-day appeal period has expired. We cannot assure you that an appeal will not be filed, and therefore we could be subject to incur additional significant costs and/or result in the further diversion of the attention of management and other key employees.

We will incur increased costs and compliance risks as a result of being a public company.

We completed our initial public offering in February 2007. As a public company, we have and expect to continue to incur significant legal, accounting and other expenses that we did not incur as a private company. These expenses are associated with our public company reporting requirements and certain corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002 and the new rules implemented by the SEC and the NASDAQ Stock Market. Compliance with these rules and regulations, in particular Section 404 of the Sarbanes-Oxley Act of 2002, has increased, and is expected to continue to substantially increase our legal and financial compliance costs and will likely require us to hire additional personnel and/or consultants. Like many smaller public companies, we expect to face a significant impact from required compliance with Section 404 of the Sarbanes-Oxley Act of 2002. The process of strengthening our internal control and complying with Section 404 has been and is expected to continue to be expensive and time consuming, and has and is expected to continue to require significant time and attention from our management team. We continue to evaluate and monitor developments with respect to these new rules, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs.

We also expect these new rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as executive officers.

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

Management has identified a material weakness in our financial statement close process and contributing deficiencies in our information technology general controls and has concluded that our internal control over financial reporting were not effective as of December 31, 2007. If we fail to adequately address this material weakness, we may not be able to improve our system of internal control over financial reporting to comply with the reporting requirements applicable to public companies in the United States. Furthermore, because we have not completed the testing of the operation of our internal controls, it is possible that we or our auditors will identify additional material weaknesses or significant deficiencies in the future in our system of internal control over financial reporting. Our failure to address any deficiencies or weaknesses in our internal control over financial reporting or to properly maintain an effective system of internal control over financial reporting could impact our ability to prevent fraud or to issue our financial statements in a timely manner that presents fairly our financial condition and results of operations. The existence of any such deficiencies or weaknesses, even if cured, may also lead to the loss of investor confidence in the reliability of our financial statements, could harm our business and negatively impact the trading price of our common stock. Such deficiencies or material weaknesses may also subject us to lawsuits, investigations and other penalties.

In addition, Section 404 of the Sarbanes-Oxley Act of 2002 required us to evaluate and report on our internal control over financial reporting with the Annual Report on Form 10-K for the year ended December 31, 2007, and have our independent auditors attest to our evaluation, beginning with our Annual Report on Form 10-K for the year ending December 31, 2009. While we have prepared an internal plan of action for compliance with Section 404 and for strengthening and testing our system of internal control to provide the basis for our report and the attestation report by our independent auditing firm, we cannot assure you that this plan of action will be sufficient to meet the rigorous requirements of Section 404, and our independent auditors may issue an adverse opinion regarding management's assessment of Section 404 compliance. Our failure to comply with Section 404 or our reporting requirements would reduce investors' confidence in our financial statements and harm our stock price and could subject us to a variety of administrative sanctions, including the suspension or delisting of our common stock from the NASDAQ Global Market and the inability of registered broker/dealers to make a market in our common stock, which could also cause our stock price to decline.

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 be 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.

General Market and Industry Risk

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

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

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

Our investment securities consist of high-grade ARPS. As of September 30, 2008, our long-term marketable securities were comprised of \$6.5 million of high-grade (AAA rated) ARPS issued primarily by close end funds that primarily hold debt obligations from municipalities. The recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings, including their holdings of ARPS. In response to the credit situation, on February 8, 2008, we instructed our investment advisor to liquidate all our investments in close end funds and move these funds into money market investments. On February 13, 2008, we were informed that there was insufficient demand at auction for our remaining four high-grade ARPS, representing approximately \$7.8 million. As a result, these affected securities currently are not liquid, and have been reclassified as long-term investments. As of September 30, 2008, \$1.3 million of its investments in ARPS were redeemed. We do not know when we will have access to the capital in these remaining investments. In the event we need to access the funds that are in an illiquid state, we will not be able to do so without a loss of principal or until a future auction on these investments is successful, the securities are redeemed by the issuer or a secondary market emerges. If we cannot readily access these funds, we may be required to borrow funds or issue additional debt or equity securities to meet our capital requirements. At this time, management has concluded that these remaining investments are impaired and has recorded an impairment charge to other comprehensive income totaling \$149,000. Management is not sure that these investments will not be settled in the short term, although the market for these investments is presently uncertain. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an additional impairment charge.

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

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

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

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

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

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

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

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

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

Additionally, in 2008, New York enacted a measure that requires many online retailers to begin collecting sales taxes on purchases shipped to the state, even if they have no operations or employees working there.

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

We sell aftermarket auto parts consisting of body and engine parts used for repair and maintenance, performance parts used to enhance performance or improve aesthetics and accessories that increase functionality or enhance a vehicle's features. Demand for our products may 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. In expanding economies, consumers may be more likely to purchase new vehicles instead of repairing existing vehicles or they may be less price sensitive, leading to an increase in OEM parts sales at dealerships, either of which could also result in a decline in our sales. If such decreases in demand for our products are not offset by other factors, such as the deferral of new car purchases in declining economies, which may result in more required repairs for older vehicles, or the purchase of performance parts and accessories in expanding economies, our financial condition and results of operations would suffer. 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.

Vehicle miles driven may decrease, resulting in a decline of our revenues and negatively affecting our results of operations.

We and our industry depend on the number of vehicle miles driven. Factors that may cause the number of vehicle miles and our revenues and our results of operations to decrease include; the economy, as described above; gas prices, as increases in gas prices may deter consumers from using their vehicles; and travel patterns, as changes in travel patterns may cause consumers to rely more heavily on train and airplane transportation.

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

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

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

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

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. 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, may have a material adverse effect on our business, prospects, financial condition and results of operations by, among other things, impeding the growth of the Internet, subjecting us to fines, penalties, damages or other liabilities, requiring costly changes in our business operations and practices, and reducing customer demand for our products and services. We do not maintain insurance coverage to cover the types of claims or liabilities that could arise as a result of such regulation.

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

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

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

Sales of Unregistered Securities

None.

Use of Proceeds from Sales of Registered Securities

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

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

Approximately \$28.0 million of the net proceeds from the offering was used to repay our outstanding indebtedness under two term loans for approximately \$18.0 million and \$10.0 million, payable to our commercial lender. In addition, \$5.0 million of the net proceeds from the offering has been paid on the notes payable to the former stockholders of Partsbin. Except for the payment of such debt, none of the net proceeds from the offering were paid directly or indirectly to any of our directors or officers (or their associates) or persons owning ten percent or more of any class of our equity securities or to any other affiliate, other than in the form of wages or salaries and bonuses paid out in the ordinary course of business. In July 2008, the Company used \$3.4 million to pay litigation settlement costs related to the stockholder class action lawsuit. See Note 5 of Notes to the Unaudited Condensed Consolidated Financial Statements in Part I of this report. The remaining net proceeds from the offering have been invested in investment-grade securities and cash equivalents. We will retain broad discretion over the use of the net proceeds received from our initial public offering. The amount and timing of our actual expenditures may vary significantly depending on a number of factors, including, but not limited to, the growth of our sales and customer base, the type of efforts we make to build our brand, and investments in our business.

ITEM 3. Defaults Upon Senior Securities.

None.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

(a) Exhibits

The following exhibits are filed herewith.

Exhibit No.	Description
10.1	Stipulation of settlement in the matter entitled: In re U.S. Auto Parts Network, Inc. Securities Litigation, Case No. CV 07-2030-GW (JC)
31.1	Certification of the principal executive officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the principal financial officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

Dated: November 6, 2008

U.S. AUTO PARTS NETWORK, INC.
(Registrant)

By /s/ SHANE EVANGELIST

Shane Evangelist
Chief Executive Officer
(Principal Executive Officer)

By /s/ MICHAEL J. McCLANE

Michael J. McClane
Chief Financial Officer
(Principal Financial Officer)

EXHIBIT INDEX

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Kim E. Miller, (SBN 178370)
 KAHN GAUTHIER SWICK, LLC
 12 E. 41st St., Ste. 1200
 New York, New York 10017
 Tel: (xxx) xxx-xxxx
 Fax: (xxx) xxx-xxxx
 E-mail: xxxxxxxxxxxx

Elaine Byszewski (SBN 222304)
 HAGENS BERMAN SOBOL
 SHAPIRO LLP
 700 South Flower Street, Suite 2940
 Los Angeles, CA 90017
 Tel: (xxx) xxx-xxxx
 Fax: (xxx) xxx-xxxx

Lewis S. Kahn
 KAHN GAUTHIER SWICK, LLC
 650 Poydras St., Suite 2150
 New Orleans, LA 70130
 Tel: (xxx) xxx-xxxx
 Fax: (xxx) xxx-xxxx
 E-mail: xxxxxxxxxxxx

Liaison Counsel for the Class

Lead Counsel for the Class

**UNITED STATES DISTRICT COURT
 CENTRAL DISTRICT OF CALIFORNIA
 WESTERN DIVISION**

)	Master File No.: CV 07-2030-GW (JC)
)	
)	CLASS ACTION
)	
In re: U.S. AUTO PARTS NETWORK, INC. SECURITIES LITIGATION)	STIPULATION OF SETTLEMENT
)	
)	
)	
)	
)	
)	

This Stipulation of Settlement dated as of May 1, 2008 (the “Stipulation”), is made and entered into by and among the following Settling Parties (as defined further in Section IV hereof) to the above-entitled Litigation: (i) the Lead Plaintiff (on behalf of itself and each of the Class Members), by and through its counsel of record in the Litigation; and (ii) the Defendants, by and through their counsel of record in the Litigation. The Stipulation is intended by the Settling Parties to fully, finally, and forever resolve, discharge, and settle the Released Claims, upon and subject to the terms and conditions hereof

I. THE LITIGATION

On and after March 28, 2007, the following actions were filed in the United States District Court for the Central District of California, Western Division, as securities class actions on behalf of purchasers of the publicly-traded securities of U.S. Auto Parts Network, Inc. (“U.S. Auto” or the “Company”) during a defined period of time:

CASE NAME	CASE NUMBER
<i>Johnson v. US. Auto Parts, et al.</i>	2:07-cv-02030-GW-JC
<i>Nopper v. US. Auto Parts, et al.</i>	2:07-cv-02775-GW-JC

On May 15, 2007, the Court consolidated the above cases as In re U.S. Auto Parts Network, Inc., 2:07-cv-02030. On August 16, 2007, the Court appointed Sasco Investments, LP as Lead Plaintiff pursuant to §21D(a)(3)(B) of the Securities Act of 1933 (the “Securities Act”), as amended by the Private Securities Litigation Reform Act of 1995 (the “PSLRA”), and approved its selection of Kahn Gauthier Swick, LLC as Lead Counsel in the consolidated action (the “Litigation”), and Hagens Berman Sobol Shapiro, LLP as liaison counsel.

On September 5, 2007, a competing lead plaintiff movant that was not appointed moved to intervene pursuant to Federal Rule of Civil Procedure 24. On September 24, 2007, Lead Plaintiff filed a non-opposition to the motion to intervene. On September 25, 2007, the motion to intervene was withdrawn.

In anticipation of filing a consolidated amended pleading, Lead Plaintiff conducted an intensive investigation and filed the operative complaint in the Litigation, the Amended Consolidated Class Action Complaint for Violation of Federal Securities Laws (the “Complaint”), on October 4, 2007.

The Defendants named in the Complaint are: U.S. Auto Parts Network, Inc. (“the Company”); Sol Khazani, Chairman of the Company’s Board and co-founder of the Company during the relevant time period; Mehran Nia, President, CEO, and Director of the Company and a member of the Board of Directors during the relevant time period; Richard Pine, Vice President of Strategic Planning and Director for the Company during the relevant time period; Company board members Frederic W. Harman, Robert J. Matjeles, and Ellen F. Siminoff; and Michael J. McClane, CFO, Executive Vice President of Finance, and Treasurer of the Company during the relevant time period (collectively, “the Individual Defendants”); Oak Investment Partners XI, LP (“Other Controlling Defendant”); and RBC Capital Markets Corporation, Thomas Weisel Partners, LLC, Piper Jaffray & Co., and JMP Securities LLC (collectively, the “Underwriter Defendants”).

The Complaint alleges violations of §§11, 12 and 15 of the Securities Act on behalf of a class of all purchasers of the publicly-traded securities of U.S. Auto between February 9, 2007 (the date of the Company's Initial Public Offering ("IPO")) and March 20, 2007, inclusive (the "Class Period"). The Complaint alleges that at the time of the IPO there existed negative conditions which were not disclosed in the IPO Registration Statement and Prospectus and which adversely affected the Company.

The Complaint alleges that the Company had failed to properly integrate the recently-acquired ThePartsbin.com, Inc. ("Partsbin"), which used a very different system to conduct business. ¶¶37-38. The companies' systems were not cross-connected and orders had to be entered manually, the Company stocked inventory in warehouses and used live salespersons to process orders while Partsbin had no inventory and no sales personnel to process orders. ¶¶42, 38-39. The Company could not assimilate Partsbin's drop-ship order fulfillment system or Partsbin's diverse business culture and operations. ¶¶38-39.

The Complaint further alleges that the Company was also unable or failed to fill customer orders, to keep the online catalogue information current, or to retain key employees from Partsbin's catalog department that were crucial to successfully integrating the two companies and ensuring that the dual order fulfillment methods were working properly and had oversight by trained personnel. Inventory was often not available or was priced differently than advertised. ¶¶43-47. Partsbin sent customers incomplete or incorrect orders to prevent the issuance of customer credits and erected obstacles to obtaining those credits. Revenues were inflated as a result of customer cancellations for improperly filled orders. *Id.*

The Complaint alleges that the Company also failed to disclose substantial credit risks associated with Partsbin's drop-ship order fulfillment system, under which Partsbin was responsible for paying the third-party vendors, who shipped the orders directly, whether or not the customer payment came through. ¶¶48-49. Partsbin faced inventory risks because returned parts were sent directly to Partsbin, and not to the vendors. Partsbin risked receiving thousands of dollars of returned merchandise daily with no adequate control or ability to predict inventory return levels. In addition, Plaintiff alleges that Partsbin also had credit programs which inflated revenue reporting by unnecessarily delaying the issuance of customer credits through a complicated multi-step process, not disclosed to customers, through which customers must go to obtain credits, ¶¶50-58.

The Complaint alleges that the Company also failed to disclose materially decreased profit margins and revenues in the period leading up to the IPO, (¶¶59-60) material control deficiencies which operated to prevent minimum standards of good corporate governance or controls and procedures, as required by the Securities Exchange Commission ("SEC") and the Company's own internal guidelines and standards of business conduct. ¶¶61-63. And, at the time of the IPO, Defendants had not conducted an adequate due diligence into the Company or the recently-acquired Partsbin. ¶62.

Further, the Complaint alleges the Company failed to maintain adequate staff to address customer complaints and other issues, in spite of letters from the Better Business Bureau, complaints from attorneys, and complaints from Attorneys General of various States. ¶¶64-71. The extremely high volume of Partsbin customer complaints involving failure of Partsbin to issue credits for returned or cancelled or wrong merchandise and the lack of an adequate procedure or control mechanism at Partsbin to deal with and adequately address the issues arising therefrom or any adequate control, were omitted from the Prospectus. ¶69.

The Complaint alleges that the Company also made material misstatements as to its business plan, growth strategy, and the state of the integration of Partsbin. ¶¶72-75. The statements failed to reflect the Company's failure to integrate, its inability to properly fill customer orders, or its inability to keep its crucial online catalogue updated. The Company stated that customers experienced tangible benefits from the Company's business model and operations solutions, when in fact the adverse conditions at the Company prevented any such benefits from being realized. ¶¶76-79. The IPO also contained untrue statements about the Company's order fulfillment system, available inventory, and reserve for returns, statements which were for the reasons discussed above. ¶¶80-81. Additionally, the Company failed to maintain adequate technology and management systems, contrary to statements in the IPO touting the Company's technological competencies. ¶¶82-83.

The Complaint alleges that the Company also suffered from numerous GAAP and SEC regulation violations by failure to adequately disclose, despite SEC requests that the Company do so, the issues regarding Partsbin integration, the Company's revenue recognition policies, the Company's true return and credit policies, and the Company's inventory and order fulfillment issues. ¶¶84-110. The IPO also failed to adequately disclose the internal control issues at the Company, issues which prevented the Company from being able to assure strict compliance with its internal guidelines for accounting, financial reporting and forecasting - including its use of estimates. ¶¶111-114.

On March 20, 2007, after Defendants announced results for the fourth quarter and full year 2007 that were well below plan, over 18.33 million shares of U.S. Auto Parts traded, more than 1.8 times the number of shares sold in the IPO, and the stock subsequently fell over 50%. The Complaint alleges that upon the publication of this news, the true undisclosed negative conditions that existed at the time of the February 2007 IPO, and that continued to adversely impact the Company after that time, came to light. As this adverse information became known to investors, the artificial inflation was immediately eliminated from U.S. Auto Parts' share price, and Class members who purchased in the IPO or traceable thereto were damaged as a result of this related share price decline.

On October 31, 2007 the Company and Individual Defendants moved the Court to dismiss the Complaint. That same day, the Underwriter Defendants filed a joinder thereto. In their motion to dismiss, Defendants argued that the Complaint's allegations sounded in fraud and were therefore subject to—and failed to meet—the requirements of Fed. R. Civ. P. 9(b), which requires allegations of fraud to be pleaded with particularity. Defendants also argued that the Complaint failed to allege actionable misstatements or omissions by Defendants; that Plaintiff failed to allege adequately that the alleged misstatements and omissions had caused Plaintiff's losses; and that Plaintiff failed to adequately allege control person liability against Oak Investment Partners XI, LP ("the Other Controlling Defendant"). Defendants concluded that these arguments together rendered Plaintiff's allegations in the Complaint legally insufficient, and on that basis moved the Court to dismiss the Complaint pursuant to Fed. R. Civ. Pr. 9(b) and 12(b)(6).

On November 27, Lead Plaintiff filed its memorandum of law in opposition to Defendants' motion to dismiss, responding to each of Defendants' arguments. Plaintiff contended that the allegations Complaint sounded in negligence, not in fraud, and that, therefore, the pleading requirement was that of Fed. R. Civ. P. 8, not the stricter requirements of 9(b). Plaintiff also argued that should the Court find that

the allegations sounded in fraud, that Plaintiff had complied with the requirements of 9(b) by alleging the what, where, when, who, and why false of each statement or omission. Plaintiff further argued that actionable misstatements or omissions by Defendants in the IPO were adequately pled; that such alleged omissions had caused Plaintiff's losses; and that Plaintiff adequately alleged control person liability against Oak Investment Partners XI, LP. Plaintiffs concluded that the allegations in the Complaint were therefore legally sufficient, and that Defendants' motion to dismiss should be denied.

On December 13, 2007 Defendants filed their reply memorandum of law in further support of their motion to dismiss the Complaint, and the next day the Underwriter Defendants filed a Joinder to that reply.

A hearing on the motion to dismiss was initially set for December 20, 2007. Pursuant to a scheduling stipulation filed by the parties, the Court continued to February 4, 2008 in order to permit the parties to conduct a mediation.

On January 30, 2007, Lead Counsel, and Counsel for the Company and the Individual Defendants met in Newport Beach, California to mediate the case before a retired United States District Judge, the Honorable Layn R. Phillips. At that time, the parties reached an agreement in principle to settle the Litigation. On February 4, 2008, the Court ordered the Hearing on the Motion to Dismiss continued to April 7, 2008 in light of the Parties' agreement in principle.

On or about February 8, 2008, Defendants produced approximately 1500 pages of emails from the files of the Chief Financial Officer, Controller, Director of Finance and Sarbanes-Oxley Manager and more than 350 Excel spreadsheets and other attachments. On March 27, 2008, documents from the Underwriter Defendants were produced. Lead Counsel carefully reviewed and analyzed all documents in order to confirm the fairness, reasonableness, and adequacy of the proposed settlement. In total, over 60,000 pages of documents were produced by Defendants.

II. DEFENDANTS' DENIALS OF WRONGDOING AND LIABILITY

Defendants have denied and continue to deny each and all of the claims and contentions alleged by Lead Plaintiff in the Litigation. Defendants expressly have denied and continue to deny all charges of wrongdoing or liability against them arising out of any of the conduct, statements, acts or omissions alleged, or that could have been alleged, in the Litigation. Defendants also have denied and continue to deny, *inter alia*, the allegations that the Lead Plaintiff and the Class have suffered damage, that the prices of U.S. Auto securities were artificially inflated by reasons of alleged misrepresentations, non-disclosures or otherwise, and that Lead Plaintiff and the Class were harmed by the conduct alleged in the Complaint, and Defendants believe that the evidence developed to date supports their position.

Nonetheless, Defendants have concluded that further conduct of the Litigation would be protracted and expensive and have taken into account the uncertainty and risks inherent in any litigation, especially in complex cases like the Litigation. Defendants have, therefore, determined that it is desirable and beneficial to them that the Litigation be settled in the manner and upon the terms and conditions set forth in this Stipulation.

III. CLAIMS OF LEAD PLAINTIFF AND BENEFITS OF SETTLEMENT

Lead Plaintiff believes that the claims asserted in the Litigation have merit and that the evidence developed to date supports the claims. However, Lead Plaintiff recognizes and acknowledges the expense and length of continued proceedings necessary to prosecute the Litigation against Defendants through trial and through appeals. Lead Plaintiff has also taken into account the uncertain outcome and the risk of any litigation, especially in complex actions such as the Litigation, as well as the difficulties and delays inherent in such litigation, as well as the risk of inability to pay a judgment by Defendants. Lead Plaintiff is also mindful of the inherent problems of proof and possible defenses to the securities law violations asserted in the Litigation. Lead Plaintiff believes that the settlement set forth in the Stipulation confers substantial benefits upon the Class. Based on their evaluation, Lead Plaintiff and Lead Counsel have determined that the settlement set forth in the Stipulation is in the best interests of the Lead Plaintiff and the Class.

IV. TERMS OF STIPULATION AND AGREEMENT OF SETTLEMENT

NOW, THEREFORE, IT IS HEREBY STIPULATED AND AGREED by and among the Lead Plaintiff (for itself and the Class Members) and Defendants, by and through their counsel, that, subject to the approval of the Court, the Litigation and the Released Claims shall be finally and fully compromised, settled, and released, and the Litigation shall be dismissed with prejudice, as to all Settling Parties, upon and subject to the terms and conditions of the Stipulation, as follows.

1. Definitions

As used in the Stipulation, the following terms have the meanings specified below:

1.1 "Authorized Claimant" means any Class Member whose claim for recovery has been allowed pursuant to the terms of the Stipulation.

1.2 "Claimant" means any Class Member who files a Proof of Claim in such form and manner, and within such time, as the Court shall prescribe.

1.3 "Claims Administrator" means Complete Claims Solutions.

1.4 "Class" means all Persons who purchased common stock of U.S. Auto pursuant to its February 9, 2007 Initial Public Offering ("IPO" or the "Offering") of 10 million shares of common stock, defined for purposes of this settlement as purchasers between February 9, 2007 and March 20, 2007. Excluded from the Class are Defendants, members of the immediate families of the Individual Defendants, current or former directors and officers of U.S. Auto and the legal representatives, heirs, successors, or assigns of any such excluded Person. Also excluded from the Class are those Persons who timely and validly request exclusion from the Class pursuant to the Notice of Pendency and Proposed Settlement of Class Action.

- 1.5 “Class Member” or “Member of the Class” means a Person who falls within the definition of the Class as set forth in ¶1.4 of the Stipulation.
- 1.6 “Class Period” means February 9, 2007 to March 20, 2007.
- 1.7 “U.S. Auto” means U.S. Auto Parts Network, Inc.
- 1.8 “Defendants” means U.S. Auto, the Individual Defendants, and the Underwriter Defendants.
- 1.9 “Effective Date” means the first date by which all of the events and conditions specified in ¶7.1 of the Stipulation have been met and have occurred.
- 1.10 “Escrow Agent” means Kahn Gauthier Swick, LLC, or its successor(s).
- 1.11 “Final” means when the last of the following with respect to the Judgment approving the Stipulation, substantially in the form of Exhibit B hereto, shall occur: (i) the expiration of the time to file a motion to alter or amend the Judgment under Federal Rule of Civil Procedure 59(e) has passed without any such motion having been filed; (ii) the expiration of the time in which to appeal the Judgment has passed without any appeal having been taken, which date shall be deemed to be thirty (30) days following the entry of the Judgment, unless the date to take such an appeal shall have been extended by Court order or otherwise, or unless the 30th day falls on a weekend or a Court holiday, in which case the date for purposes of this Stipulation shall be deemed to be the next business day after such 30th day; and (iii) if such motion to alter or amend is filed or if an appeal is taken, immediately after the determination of that motion or appeal so that it is no longer subject to any further judicial review or appeal whatsoever, whether by reason of affirmance by a court of last resort, lapse of time, voluntary dismissal of the appeal or otherwise, and in such a manner as to permit the consummation of the settlement substantially in accordance with the terms and conditions of this Stipulation. For purposes of this paragraph, an “appeal” shall include any petition for a writ of certiorari or other writ that may be filed in connection with approval or disapproval of this settlement, but shall not include any appeal that concerns only the issue of attorneys’ fees and reimbursement of costs or the Plan of Allocation of the Settlement Fund.
- 1.12 “Individual Defendants” means Sol Khazani, Mehran Nia, Richard E. Pine, Frederic W. Harman, Robert J. Majteles, Ellen F. Siminoff, and Michael J. McClane.
- 1.13 “Other Controlling Defendant” means Oak Investment Partners XI, LP.
- 1.14 “Underwriter Defendants” means RBC Capital Markets Corporation, Thomas Weisel Partners LLC, Piper Jaffray & Co. and JMP Securities LLC.
- 1.15 “Judgment” means the judgment to be rendered by the Court, substantially in the form attached hereto as Exhibit B.
- 1.16 “Lead Counsel” means Kahn Gauthier Swick, LLC.
- 1.17 “Lead Plaintiff” means Sasco Investments, LP.
- 1.18 “Person” means an individual, corporation, partnership, limited partnership, association, joint stock company, estate, legal representative, trust, unincorporated association, government or any political subdivision or agency thereof, and any business or legal entity and their spouses, heirs, predecessors, successors, representatives, or assignees.
- 1.19 “Plan of Allocation” means a plan or formula of allocation of the Settlement Fund whereby the Settlement Fund shall be distributed to Authorized Claimants after payment of expenses of notice and administration of the settlement, Taxes and Tax Expenses, such as attorneys’ fees, costs, expenses and interest as may be awarded by the Court. Any Plan of Allocation is not part of the Stipulation and Defendants and their Related Parties shall have no responsibility for, interest in, or liability whatsoever with respect to the distribution of the Net Settlement Fund, the Plan of Allocation, the determination, administration, or calculation of claims, the payment or withholding of Taxes or Tax Expenses, any losses incurred in connection therewith, or any payment of attorneys’ fees and expenses to Lead Counsel over and above payment from the Settlement Fund.
- 1.20 “Related Parties” means each of a Defendant’s past or present directors, officers, employees, partners, insurers, co-insurers, reinsurers, agents, controlling shareholders, attorneys, accountants, auditors, advisors, investment advisors, personal or legal representatives, predecessors, successors, parents, subsidiaries, divisions, joint ventures, assigns, spouses, heirs, related or affiliated entities, any entity in which a Defendant has a controlling interest, any members of an Individual Defendant’s immediate family, or any trust of which an Individual Defendant is the settlor or which is for the benefit of an Individual Defendant’s family.
- 1.21 “Released Claims” shall collectively mean all claims demands, rights, liabilities and causes of action of every nature and description whatsoever, known or unknown, whether or not concealed or hidden, asserted or that might have been asserted, including, without limitation, claims for negligence, gross negligence, breach of duty of care and/or breach of duty of loyalty, fraud, breach of fiduciary duty, or violations of any state or federal statutes, rules or regulations or common law principles, by the Lead Plaintiff or any Class Member against the Defendants and/or their Related Parties arising out of, relating to, or in connection with the purchase or sale of the publicly-traded securities of U.S. Auto by Lead Plaintiff or any Class Member during the Class Period.
- 1.22 “Released Persons” means each and all of the Defendants and each and all of their Related Parties.
- 1.23 “Settlement Fund” means the principal amount of Ten Million (\$10,000,000) in cash to be paid to the Escrow Agent pursuant to ¶2.1 of this Stipulation, plus all interest earned thereon pursuant to ¶¶2.1, 2.2 and 2.6.
- 1.24 “Settling Parties” means, collectively, each of the Defendants, and the Lead Plaintiff on behalf of itself and the Class Members.

1.25 “Notice Order” means the preliminary order as approved by the Court for mailing and publication as defined in ¶3.1 hereof.

2. The Settlement

a. The Settlement Fund

2.1 U.S. Auto shall pay or cause to be paid the sum of Ten Million (\$10,000,000) in cash, within the time set forth in ¶ 2.2, below, into an interest bearing account maintained by the Escrow Agent in settlement of the Litigation which, with any accrued interest, shall constitute the Settlement Fund. Other than the obligation of U.S. Auto to pay or cause to be paid this amount to the Escrow Agent, no Defendant shall have any obligation to make any payment pursuant to this Agreement.

2.2 Subject to the terms of this Stipulation, U.S. Auto shall pay or cause to be paid \$100,000 of the Settlement Fund into the Escrow Account within ten (10) business days of the execution of the Notice Order as defined in ¶ 3.1 hereof. Defendants shall pay or see to the payment of the remaining balance of the Settlement Fund into the Escrow Account within 30 days following the Court’s issuance of the Notice Order.

b. The Escrow Agent

2.3 The Escrow Agent may invest the Settlement Fund deposited pursuant to ¶2.1 hereof in instruments backed by the full faith and credit of the United States Government or fully insured by the United States Government or an agency thereof and shall reinvest the proceeds of these instruments as they mature in similar instruments at their then-current market rates. The Escrow Agent shall bear all risks related to investment of the Settlement Fund.

2.4 The Escrow Agent shall not disburse the Settlement Fund except as provided in the Stipulation, by an order of the Court, or with the written agreement of counsel for all parties.

2.5 Subject to further order and/or direction as may be made by the Court, the Escrow Agent is authorized to execute such transactions on behalf of the Class Members as are consistent with the terms of the Stipulation.

2.6 All funds held by the Escrow Agent shall be deemed and considered to be in *custodia legis* of the Court, and shall remain subject to the jurisdiction of the Court, until such time as such funds shall be distributed pursuant to the Stipulation and/or further order(s) of the Court.

2.7 Within thirty (30) days after payment of the Settlement Fund to the Escrow Agent pursuant to ¶2.1 hereof, the Escrow Agent may establish a “Class Notice and Administration Fund,” and may deposit up to \$100,000 from the Settlement Fund in it. The Class Notice and Administration Fund may be used by Lead Counsel to pay costs and expenses reasonably and actually incurred in connection with providing notice to the Class, locating Class Members, assisting with the filing of claims, administering and distributing the Settlement Fund to Authorized Claimants, processing Proof of Claim and Release forms and paying escrow fees and costs, if any. The Class Notice and Administration Fund may also be invested and earn interest as provided for in ¶2.3 of this Stipulation. Any costs or expenses expended for notice or claims administration in excess of \$100,000 shall be paid from the Settlement Fund, subject to approval of Lead Counsel. In no event shall Defendants have any responsibility for or liability with respect to the Escrow Agent or its actions, the Class Notice and Administration Fund, the Settlement Fund or the administration of the Settlement Fund.

c. Taxes

2.8 (a) The Settling Parties and the Escrow Agent agree to treat the Settlement Fund as being at all times a “qualified settlement fund” within the meaning of Treas. Reg. §1.468B-1. In addition, the Escrow Agent shall timely make such elections as necessary or advisable to carry out the provisions of this ¶2.8, including the “relation-back election” (as defined in Treas. Reg. §1.468B-1) back to the earliest permitted date. Such elections shall be made in compliance with the procedures and requirements contained in such regulations. It shall be the responsibility of the Escrow Agent to timely and properly prepare and deliver the necessary documentation for signature by all necessary parties, and thereafter to cause the appropriate filing to occur.

(b) For the purpose of § 1.468B of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder, the “administrator” shall be the Escrow Agent. The Escrow Agent shall timely and properly file all informational and other tax returns necessary or advisable with respect to the Settlement Fund (including without limitation the returns described in Treas. Reg. § 1.468B-2(k)). Such returns (as well as the election described in ¶2.8(a) hereof) shall be consistent with this ¶2.8 and in all events shall reflect that all Taxes (including any estimated Taxes, interest or penalties) on the income earned by the Settlement Fund shall be paid out of the Settlement Fund as provided in ¶2.8(c) hereof.

(c) All Taxes (including any estimated Taxes, interest or penalties) arising with respect to the income earned by the Settlement Fund, including any Taxes or tax detriments that may be imposed upon the Defendants or their Related Parties with respect to any income earned by the Settlement Fund for any period during which the Settlement Fund does not qualify as a “qualified settlement fund” for federal or state income tax purposes (“Taxes”), and (b) expenses and costs incurred in connection with the operation and implementation of this ¶2.8 (including, without limitation, expenses of tax attorneys and/or accountants and mailing and distribution costs and expenses relating to filing (or failing to file) the returns described in this ¶2.8) (“Tax Expenses”), shall be paid out of the Settlement Fund; in no event shall the Defendants or their Related Parties have any responsibility for or liability with respect to the Taxes or the Tax Expenses. The Escrow Agent shall indemnify and hold each of the Defendants and their Related Parties harmless for Taxes and Tax Expenses (including, without limitation, Taxes payable by reason of any such indemnification). Further, Taxes and Tax Expenses shall be treated as, and considered to be, a cost of administration of the Settlement Fund and shall be timely paid by the Escrow Agent out of the Settlement Fund without prior order from the Court and the Escrow Agent shall be obligated (notwithstanding anything herein to the contrary) to withhold from distribution to Authorized Claimants any funds necessary to pay such amounts including the establishment of adequate reserves for any Taxes and Tax Expenses (as well as any amounts that may be required to be withheld under Treas. Reg. 1.468B-2(1)(2)). The parties hereto agree to cooperate with the Escrow Agent, each other, and their tax attorneys and accountants to the extent reasonably necessary to carry out the provisions of this ¶2.8.

(d) For the purpose of this ¶2.8, references to the Settlement Fund shall include both the Settlement Fund and the Class Notice and Administration Fund and shall also include any earnings thereon.

d. CAFA Notice

2.9 Settling Defendants shall no later than ten (10) days following the Court's entry of the Order Preliminarily Approving Settlement and Providing For Notice, and pursuant thereto, serve upon the appropriate State official of each State in which a Class Member resides and the Attorney General of the United States a notice of the proposed Settlement in compliance with the requirements of the Class Action Fairness Act, 28 U.S.C. § 1711 et seq.

e. Termination of Settlement

2.10 In the event that the Stipulation is not approved, or is terminated, canceled, or fails to become effective for any reason, the Settlement Fund and the Class Notice and Administration Fund (in each case, including accrued interest), less expenses actually incurred and properly due and owing in connection with the settlement provided for herein, shall be refunded *pro rata* to U.S. Auto and/or any other entities contributing to the Settlement Fund, as provided in ¶7.3 below.

3. Notice Order and Settlement Hearing

3.1 Promptly after execution of the Stipulation, the Settling Parties shall submit the Stipulation together with its Exhibits to the Court and shall apply for entry of an order (the "Notice Order"), substantially in the form of Exhibit A hereto, requesting, *inter alia*, the preliminary approval of the settlement set forth in the Stipulation, and approval for mailing the Notice of Pendency and Proposed Settlement of Class Action (the "Notice") substantially in the form of Exhibit A-1 hereto and publication of a summary notice substantially in the form of Exhibit A-3 hereto. The Notice shall include the general terms of the settlement set forth in the Stipulation, the proposed Plan of Allocation, the general terms of the Fee and Expense Application and the date of the Settlement Hearing.

3.2 Lead Counsel shall request that after notice is given, the Court hold a hearing (the "Settlement Hearing") and approve the settlement of the Litigation as set forth herein. At or after the Settlement Hearing, Lead Counsel also will request that the Court approve the proposed Plan of Allocation and the Fee and Expense Application. Lead Counsel may also request Court approval of an application by Lead Plaintiff for reimbursement for reasonable costs and expenses, including Plaintiffs' counsel's time spent on the Litigation. Promptly after execution of this Stipulation, the Settling Parties shall submit the Stipulation together with its Exhibits to the Court and shall apply for entry of an order (the "Notice Order"), substantially in the form of Exhibit A hereto. The Notice Order shall specifically include provisions that, among other things, will:

- (a) Preliminarily approve this Stipulation and the Settlement set forth herein as being fair, just, reasonable and adequate to all Settling Parties;
- (b) Approve the form of Notice of Pendency and Settlement of Class Action (the "Notice") (substantially in the form of Exhibit A-1 hereto) for mailing to Members of the Settlement Class;
- (c) Approve the form of Proof of Claim and Release ("Proof of Claim and Release") (substantially in the form of Exhibit A-2 hereto) for mailing to Members of the Settlement Class;
- (d) Approve a summary notice of the Settlement for publication (the "Summary Notice") (substantially in the form of Exhibit A-3 hereto);
- (e) Direct Lead Plaintiff's Counsel to mail or cause to be mailed by first class mail the Notice and the Proof of Claim and Release to those Persons in the Settlement Class who can be identified through reasonable effort, on or before the date specified in the Notice Order;
- (f) Direct that nominees who purchased or otherwise acquired U.S. Auto common stock during the relevant time periods send the Notice and Proof of Claim and Release form to all beneficial owners of such U.S. Auto common stock within ten (10) days after receipt of the Notice or send a list of the names and addresses of such beneficial owners to Lead Plaintiff's Counsel within ten (10) days of receipt of the Notice;
- (g) Direct Lead Plaintiff's Counsel to cause the Summary Notice to be published once in a widely circulated national business-oriented publication or wire service on or before the date specified in the Notice Order;
- (h) Provide that Settlement Class Members who wish to participate in the Settlement provided for in this Stipulation shall complete and file Proof of Claim and Release forms pursuant to the instructions contained therein;
- (i) Find that the notice given pursuant to subparagraphs (b)-(g) above, constitutes the best notice practicable under the circumstances, including individual notice to all Persons in the Settlement Class who can be identified upon reasonable effort, and constitutes valid, due and sufficient notice to all Persons in the Settlement Class, complying fully with the requirements of Rule 23 of the Federal Rules of Civil Procedure, the Constitution of the United States, and any other applicable law;
- (j) Schedule a hearing (the "Settlement Hearing") to be held by the Court to consider and determine whether the Settlement proposed by this Stipulation should be approved as fair, reasonable and adequate and whether the Judgment approving the Settlement should be entered;
- (k) Provide that any Settlement Class Member who so desires may exercise the right to exclude themselves from the Settlement

Class but only if they comply with the requirements for so doing as set forth in the Notice;

(l) Provide that at or after the Settlement Hearing, the Court shall determine whether the proposed Plan of Allocation should be approved;

(m) Provide that at or after the Settlement Hearing, the Court shall determine and enter an Order regarding whether and in what amount attorneys' fees and reimbursement of expenses should be awarded to Lead Plaintiff's Counsel out of the Settlement Fund;

(n) Provide that pending final determination of whether the Settlement contained in this Stipulation should be approved, neither the Lead Plaintiff nor any Settlement Class Member, either directly, representatively, or in any other capacity shall commence or prosecute any action or proceeding in any court or tribunal asserting any of the Released Claims against the Released Persons;

(o) Provide that any objections to: (i) the Settlement proposed by this Stipulation; (ii) entry of the Judgment approving the Settlement; (iii) the proposed Plan of Allocation; or (iv) Lead Plaintiff's Counsel's fee and expense application(s), and any papers submitted in support of said objections shall be considered by the Court at the Settlement Hearing only if, on or before the date specified in the Notice Order, Persons making objections shall file and serve written objections (which shall set forth each objection and the basis therefor) and copies of any papers in support of their position as set forth in the Notice Order; and

(p) Provide that the Settlement Hearing may, from time to time and without further notice to the Settlement Class, be continued or adjourned by Order of the Court.

4. Releases

4.1 Upon the Effective Date, as defined in ¶1.9 hereof, Lead Plaintiff, and each of the Class Members shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished and discharged all Released Claims against the Released Persons, whether or not such Class Member executes and delivers a Proof of Claim and Release form.

4.2 The Proof of Claim and Release to be executed by Class Members shall release all Released Claims against the Released Persons and shall be substantially in the form contained in Exhibit A-2 hereto.

4.3 Upon the Effective Date, all Class Members and anyone claiming through or on behalf of any of them, will be forever barred and enjoined from commencing, instituting, prosecuting, or continuing to prosecute any action or other proceeding in any court of law or equity, arbitration tribunal, or administrative forum, asserting the Released Claims against any of the Released Persons.

4.4 Upon the Effective Date, as defined in ¶1.9 hereof, each of the Released Persons shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished and discharged the Lead Plaintiff, each and all of the Class Members, and Lead Counsel from all claims (including Unknown Claims) arising out of, relating to, or in connection with the institution, prosecution, assertion, settlement or resolution of the Litigation or the Released Claims.

5. Administration and Calculation of Claims, Final Awards and Supervision and Distribution of Settlement Fund

5.1 The Claims Administrator shall administer and calculate the claims submitted by Class Members.

5.2 The Settlement Fund shall be applied as follows:

(a) to pay all the costs and expenses reasonably and actually incurred in connection with providing notice, locating Class Members, assisting with the filing of claims, administering and distributing the Settlement Fund to Authorized Claimants, processing Proof of Claim and Release forms and paying escrow fees and costs, if any;

(b) to pay the Taxes and Tax Expenses described in ¶2.8 hereof;

(c) to pay Lead Counsel's attorneys' fees and expenses (the "Fee and Expense Award"), to the extent allowed by the Court; and

(d) after the Effective Date, to distribute the balance of the Settlement Fund (the "Net Settlement Fund") to Authorized Claimants as allowed by the Stipulation, the Plan of Allocation, or the Court.

5.3 Upon the Effective Date and thereafter, and in accordance with the terms of the Stipulation, the Plan of Allocation, or such further approval and further order(s) of the Court as may be necessary or as circumstances may require, the Net Settlement Fund shall be distributed to Authorized Claimants, subject to and in accordance with the following.

5.4 Within ninety (90) days after the mailing of the Notice or such other time as may be set by the Court, each Person claiming to be an Authorized Claimant shall be required to submit to the Claims Administrator a completed Proof of Claim and Release, substantially in the form of Exhibit A-2 hereto, signed under penalty of perjury and supported by such documents as are specified in the Proof of Claim and Release and as are reasonably available to the Authorized Claimant.

5.5 All Class Members who fail to timely submit a Proof of Claim and Release within such period, or such other period as may be ordered by the Court, or otherwise allowed, shall be forever barred from receiving any payments pursuant to the Stipulation and the settlement set forth herein, but will in all other respects be subject to and bound by the provisions of the Stipulation, the releases contained herein, and the Judgment.

5.6 The Net Settlement Fund shall be distributed to the Authorized Claimants substantially in accordance with a Plan of Allocation to be described in the Notice and approved by the Court. If there is any balance remaining in the Net Settlement Fund after six (6) months from the date of distribution of the Net Settlement Fund (whether by reason of tax refunds, uncashed checks or otherwise), Lead Counsel shall, if

feasible, reallocate such balance among Authorized Claimants in an equitable and economic fashion. Thereafter, any balance which still remains in the Net Settlement Fund shall be donated to an appropriate, non-profit organization agreed upon by Lead Counsel.

5.7 This is not a claims-made settlement and, if all conditions of the Stipulation are satisfied and the settlement becomes Final, no portion of the Settlement Fund will be returned to U.S. Auto or any insurer.

5.8 No Person shall have any claim against Lead Counsel, the Claims Administrator or other entity designated by Lead Counsel based on distributions made substantially in accordance with the Stipulation and the settlement contained herein, the Plan of Allocation, or further order(s) of the Court.

5.9 It is understood and agreed by the Settling Parties that any proposed Plan of Allocation of the Net Settlement Fund including, but not limited to, any adjustments to an Authorized Claimant's claim set forth therein, is not a part of the Stipulation and is to be considered by the Court separately from the Court's consideration of the fairness, reasonableness and adequacy of the settlement set forth in the Stipulation, and any order or proceeding relating to the Plan of Allocation shall not operate to terminate or cancel the Stipulation or affect or delay the finality of the Court's Judgment approving the Stipulation and the settlement set forth therein (including the releases contained therein), or any other orders entered pursuant to the Stipulation.

6. Lead Counsel's Attorneys' Fees and Reimbursement of Expenses

6.1 Lead Counsel may submit an application or applications (the "Fee and Expense Application") for distributions to them from the Settlement Fund for: (a) an award of attorneys' fees; and (b) reimbursement of actual expenses, including the fees of any experts or consultants incurred in connection with prosecuting the Litigation, plus any interest on such attorneys' fees and expenses at the same rate and for the same periods as earned by the Settlement Fund (until paid), as may be awarded by the Court. Lead Counsel reserves the right to make additional applications for fees and expenses incurred. Defendants do not by this Stipulation take any position on any application for fees and expenses that Lead Counsel may file.

6.2 The attorneys' fees and expenses, as awarded by the Court, shall be paid to Lead Counsel from the Settlement Fund, as ordered, immediately after the Court executes an order awarding such fees and expenses.

6.3 The procedure for and the allowance or disallowance by the Court of any applications by Lead Counsel for attorneys' fees and expenses, including the fees of experts and consultants, to be paid out of the Settlement Fund, are not part of the settlement set forth in the Stipulation, and are to be considered by the Court separately from the Court's consideration of the fairness, reasonableness and adequacy of the settlement set forth in the Stipulation, and any order or proceedings relating to the Fee and Expense Application, or any appeal from any order relating thereto or reversal or modification thereof, shall not operate to terminate or cancel the Stipulation, or affect or delay the finality of the Judgment approving the Stipulation and the settlement of the Litigation set forth therein (including the releases contained therein).

7. Conditions of Settlement, Effect of Disapproval, Cancellation or Termination

7.1 The Effective Date of the Stipulation shall be conditioned on the occurrence of all of the following events:

- (a) the Settlement Fund has been funded as required by ¶2.1 hereof;
- (b) Defendants have not exercised their option to terminate the Stipulation pursuant to the terms of the Supplemental Agreement referenced in ¶7.8 hereof;
- (c) the Court has entered the Notice Order, as required by ¶3.1 hereof;
- (d) the Court has entered the Judgment, or a judgment substantially in the form of Exhibit B hereto; and
- (e) the Judgment has become Final, as defined in ¶1.11 hereof.

7.2 Upon the occurrence of all of the events referenced in ¶7.1 hereof, any and all remaining interest or right of Defendants in or to the Settlement Fund, if any, shall be absolutely and forever extinguished. If all of the conditions specified in ¶7.1 hereof are not met, then the Stipulation shall be canceled and terminated subject to ¶7.4 hereof unless Lead Counsel and counsel for Defendants mutually agree in writing to proceed with the Stipulation.

7.3 Unless otherwise ordered by the Court, in the event the Stipulation shall terminate, or be canceled, or shall not become effective for any reason, then within ten (10) business days after written notification of such event is sent by counsel for Defendants to the Escrow Agent and in accordance with the terms of ¶2.10 hereof; the Settlement Fund (including accrued interest), plus any amount then remaining in the Class Notice and Administration Fund (including accrued interest), less expenses and any costs which have either been disbursed pursuant to ¶2.7 hereof or are determined to be chargeable to the Class Notice and Administration Fund, shall be refunded by the Escrow Agent to the respective entities that contributed to the Settlement Fund, pursuant to written instructions from U.S. Auto or its successor-in-interest. At the request of counsel to U.S. Auto, the Escrow Agent or its designee shall apply for any tax refund owed on the Settlement Fund and pay the proceeds, after deduction of any fees or expenses incurred in connection with such application(s) for refund, pursuant to written direction from U.S. Auto or its successor-in-interest.

7.4 In the event that the Stipulation is not approved by the Court or the settlement set forth in the Stipulation is terminated or fails to become effective in accordance with its terms, the Settling Parties shall be restored to their respective positions in the Litigation as of the date this Settlement Agreement was fully executed. In such event, the terms and provisions of the Stipulation, with the exception of ¶¶2.10, 7.3-7.5, and 8.4 hereof; shall have no further force and effect with respect to the Settling Parties and shall not be used in this Litigation or in any other proceeding for any purpose, and any judgment or order entered by the Court in accordance with the terms of the Stipulation shall be treated as vacated, *nunc pro tunc*. No order of the Court or modification or reversal on appeal of any order of the Court concerning the Plan of Allocation or the amount of any attorneys' fees, costs, expenses and interest awarded by the Court to Lead Counsel shall constitute grounds for cancellation or termination of the Stipulation.

7.5 If the Effective Date does not occur, or if the Stipulation is terminated pursuant to its terms, neither the Lead Plaintiff nor Lead Counsel shall have any obligation to repay any amounts actually and properly disbursed from the Class Notice and Administration Fund. In

addition, any expenses already incurred and properly chargeable to the Class Notice and Administration Fund pursuant to ¶2.7 hereof at the time of such termination or cancellation, but which have not been paid, shall be paid by the Escrow Agent in accordance with the terms of the Stipulation prior to the balance being refunded in accordance with ¶¶2.10 and 7.3 hereof.

7.6 If a case is commenced in respect to any Defendant under Title 11 of the United States Code (Bankruptcy), or a trustee, receiver or conservator is appointed under any similar law, and in the event of the entry of a final order of a court of competent jurisdiction determining the transfer of the Settlement Fund, or any portion thereof, by or on behalf of such Defendant to be a preference, voidable transfer, fraudulent transfer or similar transaction, then, at Lead Plaintiff's option, as to such Defendant, the releases given and Judgment entered in favor of such Defendant pursuant to this Stipulation shall be null and void.

7.7 Notwithstanding the foregoing ¶7.6, Lead Plaintiff's right to nullify the releases and Judgment as to any Defendant pursuant to ¶7.6 hereof shall expire upon the Effective Date.

7.8 Pursuant to Fed. R. Civ. P. 23(e)(3), under which the parties seeking approval must file a statement identifying any agreement made in connection with the proposal, there is a Supplemental Agreement to this Stipulation of Settlement with additional provisions confidentially agreed upon between the Parties.

8. Miscellaneous Provisions

8.1 The Settling Parties (a) acknowledge that it is their intent to consummate this agreement; and (b) agree to cooperate to the extent reasonably necessary to effectuate and implement all terms and conditions of the Stipulation and to exercise their reasonable best efforts to accomplish the foregoing terms and conditions of the Stipulation.

8.2 The Settling Parties intend this settlement to be a final and complete resolution of all disputes between them with respect to the Litigation. The settlement compromises claims which are contested and shall not be deemed an admission by any Settling Party as to the merits of any claim or defense. The Final Judgment will contain a statement that during the course of the Litigation, the parties and their respective counsel at all times complied with the requirements of Federal Rule of Civil Procedure 11. While retaining their right to deny liability, Defendants agree that the amount paid to the Settlement Fund and the other terms of the settlement were negotiated in good faith by the Settling Parties, and reflect a settlement that was reached voluntarily after consultation with competent legal counsel. The Settling Parties reserve their right to rebut, in a manner that such party determines to be appropriate, any contention made in any public forum that the Litigation was brought or defended in bad faith or without a reasonable basis.

8.3 Neither the Stipulation nor the settlement contained therein, nor any act performed or document executed pursuant to or in furtherance of the Stipulation or the settlement: (a) is or may be deemed to be or may be used as an admission of, or evidence of, the validity of any Released Claim, or of any wrongdoing or liability of the Defendants or their Related Parties; or (b) is or may be deemed to be or may be used as an admission of, or evidence of, any fault or omission of any of the Defendants or their Related Parties in any civil, criminal or administrative proceeding in any court, administrative agency or other tribunal. Defendants and/or their Related Parties may file the Stipulation and/or the Judgment in any action that may be brought against them in order to support a defense or counterclaim based on principles of *res judicata*, collateral estoppel, release, good faith settlement, judgment bar or reduction or any other theory of claim preclusion or issue preclusion or similar defense or counterclaim.

8.4 All agreements made and orders entered during the course of the Litigation relating to the confidentiality of information shall survive this Stipulation, pursuant to their terms.

8.5 All of the Exhibits to the Stipulation are material and integral parts hereof and are fully incorporated herein by this reference.

8.6 The Stipulation may be amended or modified only by a written instrument signed by or on behalf of all Settling Parties or their respective successors-in-interest.

8.7 The Stipulation and the Exhibits attached hereto constitute the entire agreement among the parties hereto and no representations, warranties or inducements have been made to any party concerning the Stipulation or its Exhibits other than the representations, warranties and covenants contained and memorialized in such documents. Except as otherwise provided herein, each party shall bear its own costs.

8.8 Lead Counsel, on behalf of the Class, are expressly authorized by Lead Plaintiff to take all appropriate action required or permitted to be taken by the Class pursuant to the Stipulation to effectuate its terms and also are expressly authorized to enter into any modifications or amendments to the Stipulation on behalf of the Class which they deem appropriate.

8.9 Each counsel or other Person executing the Stipulation or any of its Exhibits on behalf of any party hereto hereby warrants that such Person has the full authority to do so.

8.10 The Stipulation may be executed in one or more counterparts. All executed counterparts and each of them shall be deemed to be one and the same instrument. A complete set of original executed counterparts shall be filed with the Court.

8.11 The Stipulation shall be binding upon, and inure to the benefit of, the successors and assigns of the parties hereto.

8.12 The Court shall retain jurisdiction with respect to implementation and enforcement of the terms of the Stipulation, and all parties hereto submit to the jurisdiction of the Court for purposes of implementing and enforcing the settlement embodied in the Stipulation.

8.13 The Stipulation and the Exhibits hereto shall be considered to have been negotiated, executed and delivered, and to be wholly performed, in the State of California, and the rights and obligations of the parties to the Stipulation shall be construed and enforced in accordance with, and governed by, the internal, substantive laws of the State of California without giving effect to that State's choice-of-law principles.

IN WITNESS WHEREOF, the parties hereto have caused the Stipulation to be executed, by their duly authorized attorneys dated as of May 1, 2008.

Dated: May 1, 2008

By: /s/KIM E. MILLER

Kim E. Miller (SBN 178380)
KAHN GAUTHIER SWICK, LLC
12 E. 41st Street, 12th Floor
New York, NY 10017
Tel: (xxx) xxx-xxxx
Fax: (xxx) xxx-xxxx
Email: xxxxxxxxxxxxxxxxx

Lewis S. Kahn
KAHN GAUTHIER SWICK, LLC
650 Poydras Street, Suite 2150
New Orleans, LA 70130
Tel: (xxx) xxx-xxxx
Fax: (xxx) xxx-xxxx
Email: xxxxxxxxxxxxxxxxx

Lead Counsel for the Class

Elaine Byszewski (SBN 222304)
HAGENS BERMAN SOBOL SHAPIRO, LLP
700 South Flower Street, Suite 2940
Los Angeles, CA 90017
Tel: (xxx) xxx-xxxx
Fax: (xxx) xxx-xxxx

Liaison Counsel for the Class

Dated: May 1, 2008

By: /s/NINA F. LOCKER

Nina F. Locker
Peri Nielsen
Luke Liss
WILSON SONSINI GOODRICH & ROSATI P.C.
650 Page Mill Road
Palo Alto, California 94304-1050
Tel: (xxx) xxx-xxxx
Fax: (xxx) xxx-xxxx

Counsel for Defendants U.S Auto Parts Network, Inc., Sol Khazani, Mehran Nia, Michael J. McClane, Richard E. Pine, Robert T. Majteles, Frederic W. Harman, Ellen F. Siminoff and Oak Investment Partners XI, LLC

Dated: May 1, 2008

By: /s/ROBERT A. SACKS

Robert A. Sacks
Diane L. McGimsey
SULLIVAN & CROMWELL LLP
1888 Century Park East
Los Angeles, CA 90067
Tel: (xxx) xxx-xxxx
Fax: (xxx) xxx-xxxx

Counsel for Defendants RBC Capital Markets Corporation, Thomas Weisel Partners LLC, Piper Jaffray & Co. and JMP Securities LLC

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Shane Evangelist, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: November 6, 2008

/s/ SHANE EVANGELIST

Shane Evangelist
Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael J. McClane, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: November 6, 2008

/s/ MICHAEL J. McCLANE

Michael J. McClane,
Chief Financial Officer
(Principal Financial Officer)

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

In connection with the Quarterly Report of U.S. Auto Parts Network, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Shane Evangelist, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: November 6, 2008

/s/ SHANE EVANGELIST

Shane Evangelist
Chief Executive Officer

A signed original of this written statement required by Section 906, or any other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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

In connection with the Quarterly Report of U.S. Auto Parts Network, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael J. McClane, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: November 6, 2008

/s/ MICHAEL J. McCLANE

Michael J. McClane
Chief Financial Officer

A signed original of this written statement required by Section 906, or any other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.