U.S. Auto Parts Network, Inc.
Form 10-Q
August 09, 2018

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 001-33264

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

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

16941 Keegan Avenue, Carson, CA 90746
(Address of Principal Executive Office) (Zip Code)
(424) 702-1455
(Registrant's telephone number, including area code)

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

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

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

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

As of August 4, 2018, the registrant had 34,984,454 shares of common stock outstanding, $0.001 par value.

U.S. AUTO PARTS NETWORK, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THIRTEEN AND TWENTY-SIX WEEKS ENDED JUNE 30, 2018
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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 wholly-owned and majority-owned subsidiaries. Unless otherwise stated, all amounts are presented in thousands. In addition, unless the context requires otherwise, references to AutoMD refer to AutoMD, Inc., our former majority-owned subsidiary which was dissolved in March 2017.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

CONSOLIDATED BALANCE SHEETS

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

	June 30, 2018	December 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$6,824	$ 2,850
Short-term investments	5	9
Accounts receivable, net	2,633	2,470
Inventory	54,187	54,231
Other current assets	3,639	2,972
Total current assets	67,288	62,532
Deferred income taxes	20,467	21,476
Property and equipment, net	14,887	15,085
Intangible assets, net	557	651
Other non-current assets	1,545	954
Total assets	$104,744	$ 100,698
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$34,156	$ 35,999
Accrued expenses	13,604	7,363
Current portion of capital leases payable	588	579
Customer deposits	596	2,500
Other current liabilities	3,049	2,457
Total current liabilities	51,993	48,898
Capital leases payable, net of current portion	8,869	9,173
Other non-current liabilities	2,314	2,266
Total liabilities	63,176	60,337
Commitments and contingencies		
Stockholders' equity:		
Series A convertible preferred stock, $0.001 par value; $1.45 per share liquidation value or aggregate of $6,017; 4,150 shares authorized; 2,771 shares issued and outstanding at both June 30, 2018 and December 30, 2017	3	3
Common stock, $0.001 par value; 100,000 shares authorized; 34,973 and 34,666 shares issued and outstanding at June 30, 2018 and December 30, 2017 (of which 2,525 are treasury stock)	37	37
Treasury stock	(7,146)	(7,146)
Additional paid-in capital	180,641	179,906
Accumulated other comprehensive income	604	557
Accumulated deficit	(132,571)	(132,996)
Total stockholders' equity	41,568	40,361
Total liabilities and stockholders' equity	$104,744	$ 100,698

See accompanying notes to consolidated financial statements (unaudited).

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Net sales	$ 76,973	$ 80,208	$ 155,358	$ 161,041
Cost of sales [1]	55,488	56,964	110,414	114,010
Gross profit	21,485	23,244	44,944	47,031
Operating expenses:				
Marketing	9,818	10,248	19,800	20,562
General and administrative	4,741	4,310	9,626	9,111
Fulfillment	5,394	5,929	11,242	12,011
Technology	998	1,136	2,086	2,409
Amortization of intangible assets	47	112	94	224
Total operating expenses	20,998	21,735	42,848	44,317
Income from operations	487	1,509	2,096	2,714
Other income (expense):				
Other, net	(7)	19	(6)	35
Interest expense	(421)	(469)	(854)	(847)
Total other expense, net	(428)	(450)	(860)	(812)
Income from continuing operations before income taxes	59	1,059	1,236	1,902
Income tax provision	544	(25,859)	986	(25,832)
(Loss) income from continuing operations	(485)	26,918	250	27,734
Discontinued operations [2]				
Loss from operations and disposal of discontinued AutoMD operations	—	—	—	(558)
Income tax provision	—	—	—	1
Loss on discontinued operations	—	—	—	(559)
Net (loss) income	(485)	26,918	250	27,175
Other comprehensive income (loss):				
Foreign currency translation adjustments	23	(1)	42	(3)
Total other comprehensive income (loss)	23	(1)	42	(3)
Comprehensive (loss) income	$ (462)	$ 26,917	$ 292	$ 27,172
(Loss) income from continuing operations per share:				
Basic (loss) income from continuing operations per share	$ (0.02)	$ 0.76	$ 0.00	$ 0.79
Diluted (loss) income from continuing operations per share	$ (0.02)	$ 0.67	$ 0.00	$ 0.69
Weighted average common shares outstanding:				
Shares used in computation of basic (loss) income from continuing operations per share	34,972	35,332	34,896	34,921
Shares used in computation of diluted (loss) income from continuing operations per share	34,972	39,933	35,258	40,079

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

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

See accompanying notes to consolidated financial statements (unaudited).

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

	Twenty-Six Weeks Ended June 30, 2018	July 1, 2017
Operating activities		
Net income	$ 250	$ 27,175
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	2,993	3,270
Amortization of intangible assets	94	224
Deferred income taxes	920	(25,881)
Share-based compensation expense	1,137	1,633
Stock awards issued for non-employee director service	7	5
Amortization of deferred financing costs	2	30
Gain from disposition of assets	—	(8)
Changes in operating assets and liabilities:		
Accounts receivable	(163)	568
Inventory	44	(1,291)
Other current assets	(1,270)	(86)
Other non-current assets	1	166
Accounts payable and accrued expenses	4,560	7,261
Other current liabilities	(929)	(764)
Other non-current liabilities	195	168
Net cash provided by operating activities	7,841	12,470
Investing activities		
Additions to property and equipment	(2,940)	(2,494)
Proceeds from sale of property and equipment	—	39
Net cash used in investing activities	(2,940)	(2,455)
Financing activities		

Borrowings from revolving loan payable	3,189			3,645		
Payments made on revolving loan payable	(3,189		)	(3,645		)
Proceeds from stock options	—			238		
Minority shareholder redemption	—			(2,485		)
Payments on capital leases	(293		)	(278		)
Treasury stock repurchase	—			(2,272		)
Statutory tax withholding payment for share-based compensation	(430		)	(1,644		)
Payment of liabilities related to financing activities	(100		)	(100		)
Preferred stock dividends paid	(80		)	(169		)
Net cash used in financing activities	(903		)	(6,710		)
Effect of exchange rate changes on cash	(24		)	(20		)
Net change in cash and cash equivalents	3,974			3,285		
Cash and cash equivalents, beginning of period	2,850			6,643		
Cash and cash equivalents, end of period	$	6,824		$	9,928	
Supplemental disclosure of non-cash investing and financing activities:						
Accrued asset purchases	$	680		$	712	
Supplemental disclosure of cash flow information:						
Cash paid during the period for income taxes	$	44		$	42	
Cash paid during the period for interest	869			711		

See accompanying notes to consolidated financial statements (unaudited).

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U.S. AUTO PARTS NETWORK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In Thousands, Except Per Share Data)
Note 1 – Basis of Presentation and Description of Company
U.S. Auto Parts Network, Inc. (including its subsidiaries) is a leading online provider of aftermarket auto parts and accessories and was established in 1995. The Company entered the e-commerce sector by launching its first website in 2000 and currently derives the majority of its revenues from online sales channels. The Company sells its products to individual consumers through a network of websites and online marketplaces. Our flagship consumer websites are located at www.autopartswarehouse.com, www.carparts.com, and www.jcwhitney.com and our corporate website is located at www.usautoparts.net. References to the "Company," "we," "us," or "our" refer to U.S. Auto Parts Network, Inc. and its consolidated subsidiaries.

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

The Company is a Delaware C corporation and is headquartered in Carson, California. The Company has employees located in both the United States and the Philippines.
Basis of Presentation
The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions to U.S. Securities and Exchange Commission ("SEC") Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of June 30, 2018 and the consolidated results of operations and cash flows for the thirteen and twenty-six weeks ended June 30, 2018 and July 1, 2017. The Company's results for the interim periods are not necessarily indicative of the results that may be expected for any other interim period, or for the full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 30, 2017, which was filed with the SEC on March 14, 2018 and all our other periodic filings, including Current Reports on Form 8-K, filed with the SEC after the end of our 2017 fiscal year, and throughout the date of this report.
During the thirteen and twenty-six weeks ended June 30, 2018, the Company had a net loss of $485 and net income of $250, respectively, compared to net income of $26,918 and $27,175 during the thirteen and twenty-six weeks ended July 1, 2017, respectively. Based on our current operating plan, we believe that our existing cash, cash equivalents, investments, cash flows from operations and available debt financing will be sufficient to finance our operational cash needs through at least the next twelve months.
Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606), which was further updated in March, April, May and December 2016. The guidance in this update supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition". Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer. We adopted this ASU on December 31, 2017 through the modified retrospective method, with a cumulative adjustment that decreased accumulated deficit by approximately $342. The cumulative adjustment related to no longer recording a synthetic shipping lag adjustment, as we began to recognize revenue upon shipment.

Note 2 –Intangible Assets, Net
Intangible assets consisted of the following at June 30, 2018 and December 30, 2017 (in thousands):

		June 30, 2018			December 30, 2017		
	Useful Life	Gross Carrying Amount	Accumulated Amort. and Impairment	Net Carrying Amount	Gross Carrying Amount	Accumulated Amort. and Impairment	Net Carrying Amount
Intangible assets subject to amortization:							
Product design intellectual property	4 years	$2,750	$ (2,750)	$ —	$2,750	$ (2,750)	$ —
Patent license agreements	3 - 5 years	462	(404)	$ 58	462	(360)	$ 102
Domain and trade names	10 years	1,407	(908)	$ 499	1,407	(858)	$ 549
Total		$4,619	$ (4,062)	$ 557	$4,619	$ (3,968)	$ 651

Intangible assets subject to amortization are amortized on a straight-line basis. Amortization expense relating to intangible assets held for continuing operations was $47 and $94 for the thirteen and twenty-six weeks ended June 30, 2018, respectively, compared to $112 and $224 for the same periods in 2017.
The following table summarizes the future estimated annual amortization expense for these assets:

2018	$142
2019	100
2020	100
2021	100
2022	62
Thereafter	53
Total	$557

Note 3 – Borrowings
The Company maintains an asset-based revolving credit facility ("Credit Facility") that provides for, among other things, a revolving commitment in an aggregate principal amount of up to $30,000, which is subject to a borrowing base derived from certain receivables, inventory, and property and equipment. At June 30, 2018, our outstanding revolving loan balance was $0. The guaranteed total letters of credit balance at June 30, 2018 was $14,045, of which $10,350 was utilized and included in accounts payable in our consolidated balance sheet.
Loans drawn under the Credit Facility bear interest, at the Company’s option, at a per annum rate equal to either (a) LIBOR plus an applicable margin of 1.25%, or (b) an “alternate prime base rate” subject to an increase or reduction by up to 0.25% per annum based on the Company's fixed charge coverage ratio. At June 30, 2018, the Company’s LIBOR based interest rate was 3.38% (on $0 principal) and the Company’s prime based rate was 4.75% (on $0 principal). A commitment fee, based upon undrawn availability under the Credit Facility bearing interest at a rate of 0.25% per annum, is payable monthly. Under the terms of the credit agreement with JP Morgan Chase Bank (the "Credit Agreement"), cash receipts are deposited into a lock-box, which are at the Company’s discretion unless the “cash dominion period” is in effect, during which cash receipts will be used to reduce amounts owing under the Credit Agreement. The cash dominion period is triggered in an event of default or if excess availability is less than the $3,600 for three business days (on a cumulative basis) and will continue until, during the

preceding 60 consecutive days, no event of default existed and excess availability has been greater than $3,600 at all times (with such trigger subject to adjustment based on the Company's revolving commitment). In addition, in the event that “excess availability,” as defined under the Credit Agreement, is less than $2,400, the Company shall be required to maintain a minimum fixed charge coverage ratio of 1.0 to 1.0 (with the trigger subject to adjustment based on the Company's revolving commitment). The Company's excess availability was $11,229 at June 30, 2018. As of the date hereof, the cash dominion period has not been in effect; accordingly, no principal payments are due. The Credit Agreement requires us to obtain a prior written consent from JPMorgan Chase Bank when we determine to pay any dividends on or make any distribution with respect to our common stock. The credit facility matures on April 26, 2020.

Note 4 – Stockholders’ Equity and Share-Based Compensation

Options and Restricted Stock Units

The Company had the following common stock option activity during the twenty-six weeks ended June 30, 2018:

- Granted options to purchase 554 common shares.
- Exercise of 0 options to purchase common shares.
- Forfeiture of 127 option to purchase common shares.
- Expiration of 489 options to purchase common shares.

The following table summarizes the Company’s restricted stock unit ("RSU") activity for the twenty-six weeks ended June 30, 2018, and details regarding the awards outstanding and exercisable at June 30, 2018 (in thousands):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Awards outstanding, December 30, 2017	1,113	$ —		
Awarded	1,033	$ —		
Vested	(488)	$ —		
Forfeited	(348)	$ —		
Awards outstanding, June 30, 2018	1,310	$ —	1.10	$ 1,965
Vested and expected to vest at June 30, 2018	1,310	$ —	1.10	$ 1,965

During the twenty-six weeks ended June 30, 2018, 357 RSU's that vested were time-based and 131 were performance-based. For the RSUs awarded, the number of shares issued on the date of vest is net of the minimum statutory withholding requirements that we pay in cash to the appropriate taxing authorities on behalf of our employees. For those employees who elect not to receive shares net of the minimum statutory withholding requirements, the appropriate taxes are paid directly by the employee. During the twenty-six weeks ended June 30, 2018, we withheld 184 shares to satisfy $430 of employees' tax obligations. Although shares withheld are not issued, they are treated as a common stock repurchase in our consolidated financial statements, as they reduce the number of shares that would have been issued upon vesting.

For the thirteen and twenty-six weeks ended June 30, 2018, we recorded compensation expense related to stock options and RSU's of $156 and $1,158, respectively. For the thirteen and twenty-six weeks ended July 1, 2017 we recorded compensation expense related to stock options and RSU's of $555 and $1,668, respectively. As of June 30, 2018, there was unrecognized compensation expense related to stock options and RSU's of $4,471.

Non-Controlling Interest

Non-controlling interests represent equity interests in consolidated subsidiaries that are not attributable, either directly or
indirectly, to the Company (i.e., minority interests). The Company's non-controlling interests consisted of the minority equity holders' proportionate share of the equity of AutoMD. However, during March 2017, AutoMD filed for dissolution, therefore the Company no longer has any non-controlling interests.

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Note 5 – Net (Loss) Income Per Share

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Net (loss) income per share:				
Numerator:				
(Loss) income from continuing operations	$(485)	$26,918	250	27,734
Dividends on Series A Convertible Preferred Stock	40	49	80	108
(Loss) income from continuing operations available to common shares	$(525)	$26,869	$170	$27,626
Denominator:				
Weighted-average common shares outstanding (basic)	34,972	35,332	34,896	34,921
Common equivalent shares from common stock options, restricted stock, preferred stock and warrants	—	4,601	362	5,158
Weighted-average common shares outstanding (diluted)	34,972	39,933	35,258	40,079
Basic net (loss) income from continuing operations per share	$(0.02)	$0.76	$0.00	$0.79
Diluted net (loss) income from continuing operations per share	$(0.02)	$0.67	$0.00	$0.69

The anti-dilutive securities, which are excluded from the calculation of diluted earnings per share due to their anti-dilutive effect are as follows (in thousands):

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Common stock warrants	—	5	—	13
Performance stock units	343	225	384	375
Restricted stock units	504	—	515	—
Series A Convertible Preferred Stock	2,771	—	2,771	—
Options to purchase common stock	5,477	3,042		