OVERSTOCK.COM, INC
Form 10-Q
November 07, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended September 30, 2007
	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: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

Delaware	**87-0634302**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6350 South 3000 East

Salt Lake City, Utah 84121

(Address, including zip code, of

Registrant s principal executive offices)

Registrant s telephone number, including area code: **(801) 947-3100**

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), (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2 of the Exchange Act).

Large accelerated filer o Accelerated filer x Non-accelerated filer 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 x

There were 23,805,937 shares of the Registrant s common stock, par value $0.0001, outstanding on November 2, 2007.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

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

Item 3. Defaults upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

Signature

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets (unaudited)

(in thousands)

	December 31, 2006	September 30, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 126,965	$ 74,145
Marketable securities		16,842
Total cash and marketable securities	126,965	90,987
Accounts receivable, net	11,638	7,607
Notes receivable	6,702	1,506
Inventories, net	20,274	22,400
Prepaid inventory	2,241	5,003
Prepaid expense	7,473	10,257
Current assets of held for sale subsidiary	4,718	
Total current assets	180,011	137,760
Property and equipment, net	56,198	33,450
Goodwill	2,784	2,784
Other long-term assets, net	578	197
Notes receivable (Note 4)		4,045
Long-term assets of held for sale subsidiary	16,594	
Total assets	$ 256,165	$ 178,236
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 66,039	$ 38,504
Accrued liabilities	40,142	26,499
Capital lease obligations, current	5,074	3,801
Current liabilities of held for sale subsidiary	3,684	
Total current liabilities	114,939	68,804
Capital lease obligations, non-current	3,983	
Other long-term liabilities		3,113
Convertible senior notes	75,279	75,537
Total liabilities	194,201	147,454
Commitments and contingencies (Notes 12 and 13)		
Stockholders equity:		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2006 and September 30, 2007		
Common stock, $0.0001 par value, 100,000 shares authorized, 25,069 and 25,390 shares issued as of December 31, 2006 and September 30, 2007, respectively	2	2
Additional paid-in capital	325,771	332,899
Accumulated deficit	(198,694)	(238,549)
Treasury stock, 1,654 and 1,609 shares at cost as of December 31, 2006 and September 30, 2007, respectively	(64,983)	(63,435)

Accumulated other comprehensive loss		(132)		(135)
Total stockholders equity		61,964		30,782
Total liabilities and stockholders equity	$	256,165	$	178,236

The accompanying notes are an integral part of these consolidated financial statements.

Overstock.com, Inc.

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three months ended September 30, 2006	Three months ended September 30, 2007	Nine months ended September 30, 2006	Nine months ended September 30, 2007
Revenue				
Direct	$ 56,564	$ 39,446	$ 205,044	$ 128,725
Fulfillment partner	100,321	122,484	289,077	340,102
Total revenue	156,885	161,930	494,121	468,827
Cost of goods sold:				
Direct (1)	51,037	33,160	183,213	108,801
Fulfillment partner	84,483	100,509	243,481	280,147
Total cost of goods sold	135,520	133,669	426,694	388,948
Gross profit	21,365	28,261	67,427	79,879
Operating expenses:				
Sales and marketing (1)	17,282	8,835	41,852	28,081
Technology (1)	16,157	14,576	44,478	44,786
General and administrative (1)	11,078	9,724	33,978	30,842
Restructuring				12,283
Total operating expenses	44,517	33,135	120,308	115,992
Operating loss	(23,152)	(4,874)	(52,881)	(36,113)
Interest income	459	1,291	2,989	3,359
Interest expense	(1,096)	(1,029)	(3,638)	(3,085)
Other income, net	(6)	(92)	(7)	(92)
Loss from continuing operations	(23,795)	(4,704)	(53,537)	(35,931)
Loss from discontinued operations	(708)		(2,615)	(3,924)
Net loss	(24,503)	(4,704)	(56,152)	(39,855)
Deemed dividend related to redeemable common stock	(33)		(99)	
Net loss attributable to common shares	$ (24,536)	$ (4,704)	$ (56,251)	$ (39,855)
Net loss per common share basic and diluted:				
Loss from continuing operations	$ (1.16)	$ (0.20)	$ (2.71)	$ (1.52)
Loss from discontinued operations	$ (0.03)	$	$ (0.13)	$ (0.16)
Net loss per common share basic and diluted	$ (1.19)	$ (0.20)	$ (2.84)	$ (1.68)
Weighted average common shares outstanding basic and diluted	20,600	23,726	19,774	23,671

(1) Includes stock-based compensation from options as follows:

Cost of goods sold direct	$	103	$	117	$	308	$	338
Sales and marketing	$	77	$	85	$	225	$	248
Technology	$	173	$	195	$	513	$	560
General and administrative	$	689	$	779	$	2,042	$	2,240

The accompanying notes are an integral part of these consolidated financial statements.

Overstock.com, Inc.

Consolidated Statements of Stockholders Equity

and Comprehensive Loss (unaudited)

(in thousands)

	Common stock		Additional Paid-in	Accumulated	Treasury stock		Accumulated Other Comprehensive	
	Shares	Amount	capital	Deficit	Shares	Amount	Loss	Total
Balance at December 31, 2006	25,069	$ 2	$ 325,771	$ (198,694)	(1,654)	$ (64,983)	$ (132)	$ 61,964
Exercise of stock options	321		2,182					2,182
Treasury stock issued to employees as compensation			(620)		45	1,548		928
Stock-based compensation from employee options			3,386					3,386
Stock-based compensation to consultants in exchange for services			280					280
Stock-based compensation related to performance shares			1,900					1,900
Comprehensive loss:								
Net loss				(39,855)				(39,855)
Net unrealized gain on marketable securities							2	2
Cumulative translation adjustment							(5)	(5)
Total comprehensive loss								(39,858)
Balance at September 30, 2007	25,390	$ 2	$ 332,899	$ (238,549)	(1,609)	$ (63,435)	$ (135)	$ 30,782

The accompanying notes are an integral part of these consolidated financial statements.

Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three months ended September 30,		Nine months ended September 30,		Twelve months ended September 30,	
	2006	2007	2006	2007	2006	2007
Cash flows from operating activities of continuing operations:						
Net loss	$ (24,503)	$ (4,704)	$ (56,152)	$ (39,855)	$ (62,435)	$ (85,469)
Adjustments to reconcile net loss to cash provided by (used in) operating activities of continuing operations:						
Loss from discontinued operations	708		2,615	3,924	3,830	8,191
Depreciation and amortization	7,776	7,080	20,802	22,825	25,447	34,350
Realized gain from marketable securities			(2,085)		(1,095)	
Realized loss on disposition of property and equipment			599	1	2,056	1
Stock-based compensation	1,042	1,176	3,088	3,386	3,095	4,418
Stock-based compensation to consultants for services	(3)	140	31	280	(20)	272
Stock-based compensation relating to performance shares		350		350		350
Treasury stock issued to employees as compensation	67	213	679	928	720	1,036
Amortization of debt discount and deferred financing fees	139	86	417	258	435	258
Restructuring				12,283		17,957
Gain from retirement of convertible senior notes					(1,988)	
Notes receivable accretion		(136)		(136)		(136)
Changes in operating assets and liabilities, net of effect of acquisition and discontinued operations:						
Accounts receivable, net	1,541	335	2,880	3,731	(461)	(1,201)
Inventories, net	6,040	(6,975)	24,487	(2,126)	29,352	40,396
Prepaid inventory	(781)	(2,879)	5,605	(2,762)	8,578	(979)
Prepaid expenses	455	(1,522)	(716)	(2,784)	22	(1,064)
Other long-term assets, net	(123)	100	(105)	366	(1,821)	967
Accounts payable	11,745	4,960	(53,479)	(27,632)	(358)	(9,353)
Accrued liabilities	(3,339)	(566)	(26,908)	(18,680)	(25,837)	(3,689)
Other long-term liabilities		(114)		(114)		(114)
Net cash provided by (used in) operating activities of continuing operations	764	(2,456)	(78,242)	(45,757)	(20,480)	6,191
Cash flows from investing activities of continuing operations:						
Change in restricted cash			253		633	
Purchases marketable securities		(7,783)		(29,164)	(2,000)	(29,164)
Sales of marketable securities		8,924	56,756	12,324	76,280	12,324
Expenditures for property and equipment	(7,769)	(316)	(19,675)	(2,232)	(27,851)	(5,998)

Proceeds from the sale property and equipment	1		1		1	
Proceeds from the sale of discontinued operations, net of cash transferred				9,892		9,892
Decrease in cash resulting from deconsolidation of variable interest entity						(102)
Payments received on note receivable		502		5,196		5,196
Expenditures for other long-term assets			(100)		(100)	
Net cash provided by (used in) investing activities of continuing operations	(7,768)	1,327	37,235	(3,984)	46,963	(7,852)
Cash flows from financing activities of continuing operations:						
Payments on capital lease obligations	(124)	(5)	(2,878)	(5,256)	(6,730)	(5,335)
Drawdown on line of credit	5,245		78,503	1,169	86,003	9,347
Payments on line of credit	(5,245)		(78,503)	(1,169)	(90,371)	(9,347)
Payments to retire convertible senior notes					(7,735)	
Proceeds from the issuance of common stock			25,000		25,000	39,406
Exercise of stock options	806	261	2,267	2,182	2,701	2,449
Net cash provided by (used in) financing activities of continuing operations	682	256	24,389	(3,074)	8,868	36,520
Effect of exchange rate changes on cash	40	(26)	11	(5)	(14)	18
Cash provided by (used in) operating activities discontinued operations	42		112	(204)	67	1,265
Cash used in investing activities of discontinued operations	(39)		(343)	(53)	(441)	(276)
Net increase (decrease) in cash and cash equivalents	(6,279)	(899)	(16,838)	(53,077)	39,963	35,866
Change in cash and cash equivalents from discontinued operations	(3)		231	257	374	(989)
Cash and cash equivalents, beginning of period	45,550	75,044	55,875	126,965	3,931	39,268
Cash and cash equivalents, end of period	$ 39,268	$ 74,145	$ 39,268	$ 74,145	$ 39,268	$ 74,145
Supplemental disclosure of cash flow information:						
Interest paid	192	142	2,001	2,378	4,540	4,054
Supplemental disclosures of non-cash flow information:						
Deemed dividend on redeemable common shares	33		99		144	33
Lapse of rescission rights	2,431		3,304		3,450	
Equipment and software acquired under capital leases			2,274		2,322	

The accompanying notes are an integral part of these consolidated financial statements.

Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Overstock.com, Inc. (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited annual consolidated financial statements and related notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2006. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of results for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management s best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates. The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The consolidated financial statements include the accounts of the Company s OTravel subsidiary through April 25, 2007 (Note 4). The consolidated financial statements also include the accounts of a variable interest entity for which the Company was the primary beneficiary through November 30, 2006. All significant intercompany account balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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. Actual results could differ from those estimates.

Internal-Use Software and Website Development

The Company includes in fixed assets the capitalized cost of internal-use software and website development, including software used to upgrade and enhance its Website and processes supporting the Company s business. As required by Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* the Company capitalizes costs incurred during the application development stage of internal-use software and amortizes these costs over the estimated useful life of three years. The Company expenses costs incurred related to design or maintenance of internal-use software as incurred.

During the three months ended September 30, 2006 and 2007, the Company capitalized $7.3 million and $209,000, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $3.6 million and $3.2 million for those respective periods. For the nine months ended September 30, 2006 and 2007, the Company capitalized $19.3 million and $1.7 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $9.9 million and $10.3 million for those respective periods.

Advertising expense

The Company recognizes advertising expenses in accordance with SOP 93-7, *Reporting on Advertising Costs*. As such, the Company expenses the costs of producing advertisements at the time production occurs or the first time the advertising takes place and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to the Website that generates a sale 2) based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense included in sales and marketing expenses totaled $17.1 million and $7.8 million during the three months ended September 30, 2006 and 2007, respectively. For the nine months ended September 30, 2006 and 2007, advertising expenses totaled $41.1 million and $25.5 million, respectively.

Stock-based Compensation

As of January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) 123(R) *Share-based Payment an Amendment of FASB Statements No 123 and 95*, which requires the Company to measure compensation expense for all outstanding unvested share-based awards at fair value and recognize compensation expense over the service period for awards expected to vest. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts will be recorded as an adjustment in the period estimates are revised. Management considers many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results may differ substantially from these estimates.

Recent accounting pronouncements

In March 2006, the Emerging Issue Task Force reached a consensus on Issue No. 06-03, *How Taxes Collected from Customers and Remitted to Government Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF No. 06-03). The Company adopted the provisions of EITF No. 06-03 beginning January 1, 2007. The adoption of EITF No. 06-03 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

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). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of a full valuation allowance, the Company does not have any unrecognized tax benefits and there is no effect on its financial condition or results of operations as a result of implementing FIN 48. The Company is subject to audit by the IRS and various states for the prior 3 years. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months. The Company s policy is that it recognizes interest and penalties accrued on any unrecognized tax positions as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax positions, nor was any interest expense recognized during the three or nine months ended September 30, 2007.

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 generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements. The Company will adopt SFAS 157 on January 1, 2008. The Company anticipates that the adoption of SFAS 157 will not have a material impact on the Company s consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for the Company s fiscal year beginning January 1, 2008. The Company anticipates that the adoption of SFAS No. 159 will not have a material impact on the Company s consolidated financial statements.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period s presentation. In addition, the Company has revised its consolidated statements of operations and consolidated statements of cash flows for the three and nine months ended September 30, 2006 to present the loss from discontinued operations and the operating and investing portion of the cash flows attributable to discontinued operations on a separately identifiable basis. The effect of these reclassifications had no impact on net income, total assets, total liabilities, or stockholders equity.

3. RESTRUCTURING EXPENSE

During the fourth quarter of 2006, the Company commenced implementation of a facilities consolidation and restructuring program designed to reduce the overall expense structure in an effort to improve future operating performance. The facilities consolidation and restructuring program was substantially completed by the end of the second quarter of 2007. There were no restructuring expenses during the third quarter of 2007.

During the fiscal year 2006, the Company recorded $5.7 million of restructuring charges, of which $5.5 million, less the elimination of straight-line rent liability of $913,000, related to costs to terminate a co-location data center lease. Other costs included in the restructuring charge related to $638,000 of accelerated amortization of leasehold improvements in the Company s current office facilities that it is attempting to sublease and $450,000 of costs incurred to return these office facilities to their original condition as required by the Company s lease agreement.

During the first nine months of 2007, the Company accrued $8.0 million of restructuring charges related to the termination of a logistics services agreement, termination and settlement of a lease related to its vacated warehouse facilities in Indiana and

abandonment and marketing for sub-lease office and data center space in the current corporate office facilities. During the second quarter of 2007, the Company reached an agreement to terminate the Indiana warehouse facilities lease effective August 15, 2007 for $1.9 million, resulting in a reversal of restructuring expense of approximately $1.0 million.

The Company also recorded an additional $2.4 million of restructuring charges related to accelerated amortization of leasehold improvements located in the abandoned office and co-location data center space and $2.0 million of other restructuring charges, primarily related to consolidation of office space in the current corporate office facilities, relocation of a data center and employee severance.

Restructuring liabilities along with charges to expense, cash payments or accelerated amortization of leasehold improvements associated with the facilities consolidation and restructuring program were as follows (in thousands):

	Balance 12/31/2006	Charges to expense	Cash payment or accelerated amortization	Balance 9/30/2007
Lease and contract termination costs	$ 5,499	$ 9,424	$ (10,139)	$ 4,784
Asset retirement obligation	450		(450)	
Accelerated amortization of leasehold improvements		2,359	(2,359)	
Other restructuring expenses		500	(200)	300
Total	$ 5,949	$ 12,283	$ (13,148)	$ 5,084

4. SALE OF DISCONTINUED OPERATIONS

On July 1, 2005, the Company acquired all the outstanding capital stock of Ski West, Inc. (Ski West) for an aggregate of $25.1 million (including $111,000 of capitalized acquisition related expenses).

Ski West is an on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel offerings are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises. Effective upon the closing, Ski West became a wholly-owned subsidiary of the Company, integrated the Ski West travel offerings with the Company s existing travel offerings and changed its name to OTravel.com, Inc (OTravel).

During the fourth quarter of 2006, in conjunction with the facilities consolidation and restructuring program described in Note 3, management decided to sell OTravel. The Company evaluated its plan to sell OTravel in accordance with SFAS 144, which requires that long-lived assets be classified as held for sale only when certain criteria are met. The Company classified the OTravel assets and liabilities as held for sale as it met these criteria as of December 31, 2006, which include: management s commitment to a plan to sell the assets; availability of the assets for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets has been initiated; sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; assets are being marketed at reasonable prices in relation to their fair value; and unlikelihood that significant changes will be made to the plan to the sell the assets. The travel business is not part of the Company s core business operations and is no longer part of its strategic focus. The results of operations for the subsidiary were included in the fulfillment partner segment prior to being classified as discontinued operations.

The Company also determined that the OTravel subsidiary met the definition of a component of an entity and has been accounted for as a discontinued operation under SFAS 144. The results of operations for this subsidiary have been classified as discontinued operations in all periods presented. In conjunction with the discontinuance of OTravel, the Company performed an evaluation of the goodwill associated with the reporting unit pursuant to SFAS 142 and SFAS 144, *Accounting for the Impairment of Long-Lived Assets* and determined that goodwill of approximately $4.5 million was impaired as of December 31, 2006, based on a non-binding letter of intent from a third party to purchase this business. During the quarter ended March 31, 2007, the Company received a revised offer from this third party to purchase its OTravel business and, in April 2007, the Company completed the sale of OTravel under these revised terms. Accordingly, the Company evaluated its goodwill as of March 31, 2007 and, based on the estimated fair value of the discounted cash flows of the net proceeds from the sale, determined that an additional $3.8 million of goodwill was impaired.

On April 25, 2007, the Company completed the sale of OTravel.com to Castles Travel, Inc., an affiliate of Kinderhook Industries, LLC, and Castles Media Company LLC, for $17.0 million. The Company received cash proceeds, net of cash transferred, of $9.9 million and two $3.0 million promissory notes. The $3.0 million senior note matures three years from the closing date and bears interest, payable quarterly, of 4.0%, 10.0% and 14.0% per year in the first, second and third years, respectively. The $3.0 million junior note matures five years from the closing date and bears interest of 8.0% per year, compounded annually, and is payable in full at maturity.

The following table is a summary of the Company s discontinued operations for the nine months ended September 30, 2006 and the period ended April 25, 2007 (in thousands):

	Nine months ended September 30, 2006	Year-to-date period ended April 25, 2007
Sales	$ 4,780	$ 2,226
Cost of sales	(1,103)	(650)
Gross profit	3,677	1,576
Sales and marketing	(1,312)	(447)
Technology	(377)	(60)
General and administrative	(4,603)	(1,152)
Goodwill impairment		(3,841)
Loss from discontinued operations	$ (2,615)	$ (3,924)

The held for sale assets and liabilities consisted of the following (in thousands):

	December 31, 2006
Assets of held for sale subsidiary:	
Cash	$ 1,365
Accounts receivable	3,267
Property and equipment, net	1,215
Goodwill and intangible assets, net	15,379
Other	86
Total assets of discontinued operations	$ 21,312
Liabilities of held for sale subsidiary:	
Current liabilities:	
Accounts payable	$ 2,947
Accrued liabilities	737
Total liabilities of discontinued operations	$ 3,684

5. MARKETABLE SECURITIES

The Company s marketable securities consist of funds deposited into a capital management account managed by a financial institution at September 30, 2007 as follows:

	Amortized Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Corporate debt securities	$ 16,840	$ 2	$	$ 16,842

All marketable securities mature in 2007 and are classified as available-for-sale securities. Available-for-sale securities are classified as current as they are deemed available for use. There were no marketable securities at December 31, 2006.

Derivative instruments

During the first quarter of 2005, the Company purchased $49.9 million of Foreign Corporate Securities (Foreign Notes) which were scheduled to mature in November 2006. The Foreign Notes did not have a stated interest rate, but were structured to return the entire principal amount and a conditional coupon if held to maturity. The conditional coupon would provide a rate of return dependent on the performance of a basket of eight Asian currencies against the U.S. dollar. If the Company redeemed the Foreign Notes prior to maturity, the Company would not realize the full amount of its initial investment.

Under SFAS No. 133, the Foreign Notes were considered to be derivative financial instruments and were marked to market quarterly. Any unrealized gain or loss related to the changes in value of the conditional coupon was recorded in the income statement as a component of interest income or expense. Any unrealized gain or loss related to the changes in the value of the Foreign Notes was recorded as a component of accumulated other comprehensive income (loss).

The Company purchased the Foreign Notes to manage its foreign currency risks related to the strengthening of Asian currencies compared to the U.S. dollar, which would reduce the inventory purchasing power of the Company in Asia. However, the Company determined that the Foreign Notes did not qualify as hedging derivative instruments. Nevertheless, management believes that such instruments are useful in managing the Company s associated risk.

On April 26, 2006, the Company sold the Foreign Notes for $49.5 million resulting in a gain of $1.9 million, which the Company recognized in the second quarter of 2006 as a component of interest income. The Company had previously recorded $2.4 million of accumulated unrealized losses as a component of interest income over the period the Foreign Notes had been held.

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6. OTHER COMPREHENSIVE LOSS

The Company follows SFAS No. 130, *Reporting Comprehensive Income.* This Statement establishes requirements for reporting comprehensive income (loss) and its components. The Company s comprehensive loss is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2007	2006	2007
Net loss	$ (24,503)	$ (4,704)	$ (56,152)	$ (39,855)
Net unrealized gain on marketable securities		1		2
Unrealized gain on Foreign Notes			740	
Reclassification adjustment for gains included in net loss			(1,868)	
Foreign currency translation adjustment	40	(26)	11	(5)
Comprehensive loss	$ (24,463)	$ (4,729)	$ (57,269)	$ (39,858)

7. EARNINGS (LOSS) PER SHARE

In accordance with SFAS 128 *Earnings per share*, basic earnings (loss) per share is computed by dividing net income (loss) attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, composed of incremental common shares issuable upon the exercise of stock options, warrants and convertible senior notes, are included in the calculation of diluted net loss per share to the extent such shares are dilutive.

The following table sets forth the computation of basic and diluted earnings (loss) per share for the periods indicated (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2007	2006	2007
Loss from continuing operations	$ (23,795)	$ (4,704)	$ (53,537)	$ (35,931)
Deemed dividend related to redeemable common stock	(33)		(99)	
Loss from continuing operations attributable to common shares	(23,828)	(4,704)	(53,636)	(35,931)
Loss from discontinued operations	(708)		(2,615)	(3,924)
Net loss attributable to common shares	$ (24,536)	$ (4,704)	$ (56,251)	$ (39,855)
Weighted average common shares outstanding basic	20,600	23,726	19,774	23,671
Effective of dilutive securities:				
Stock options				
Convertible senior notes				
Weighted average common shares outstanding diluted	20,600	23,726	19,774	23,671

Net loss per common share basic and diluted:								
Loss from continuing operations	$	(1.16)	$	(0.20)	$	(2.71)	$	(1.52)
Loss from discontinued operations	$	(0.03)	$		$	(0.13)	$	(0.16)
Net loss per common share basic and diluted	$	(1.19)	$	(0.20)	$	(2.84)	$	(1.68)

The stock options, warrants and convertible senior notes outstanding were not included in the computation of diluted earnings per share because to do so would have been antidilutive. The number of stock options outstanding at September 30, 2006 and 2007 was 1,093,000 and 1,176,000, respectively. As of September 30, 2007, the Company had $77.0 million of convertible senior notes outstanding, which could potentially convert into 1,010,000 shares of common stock in the aggregate.

8. BUSINESS SEGMENTS

Segment information has been prepared in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. Segments were determined based on products and services provided by each segment. There were no inter-segment sales or transfers during the three and nine months ended September 30, 2006 or 2007. The Company evaluates the performance of its segments and allocates resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three and nine months ended September 30, 2006 and 2007 (in thousands):

	Three months ended September 30,			Nine months ended September 30,		
	Direct	Fulfillment partner	Consolidated	Direct	Fulfillment partner	Consolidated
2006						
Revenue	$ 56,564	$ 100,321	$ 156,885	$ 205,044	$ 289,077	$ 494,121
Cost of goods sold	51,037	84,483	135,520	183,213	243,481	426,694
Gross profit	$ 5,527	$ 15,838	21,365	$ 21,831	$ 45,596	67,427
Operating expenses			(44,517)			(120,308)
Other income (expense), net			(643)			(656)
Loss from continuing operations			$ (23,795)			$ (53,537)
2007						
Revenue	$ 39,446	$ 122,484	$ 161,930	$ 128,725	$ 340,102	$ 468,827
Cost of goods sold	33,160	100,509	133,669	108,801	280,147	388,948
Gross profit	$ 6,286	$ 21,975	28,261	$ 19,924	$ 59,955	79,879
Operating expenses			(33,135)			(115,992)
Other income (expense), net			170			182
Loss from continuing operations			$ (4,704)			$ (35,931)

The direct segment includes revenues, direct costs, and allocations associated with sales fulfilled from the Company s warehouses. Costs for this segment include product costs, inbound and outbound freight, warehousing and fulfillment costs, credit card fees and customer service costs.

The fulfillment partner segment includes revenues, direct costs and cost allocations associated with the Company s third party fulfillment partner sales and are earned from selling the merchandise of third parties over the Company s Website. The costs for this segment include product costs, partners warehousing and fulfillment costs, credit card fees and customer service costs.

Assets have not been allocated between the segments for management purposes and, as such, they are not presented here.

For the three and nine months ended September 30, 2006 and 2007, over 99% of sales were made to customers in the United States of America. No individual geographical area within the U.S accounted for more than 10% of net sales in any of the periods presented. At December 31, 2006 and September 30, 2007, all of the Company s fixed assets were located in the United States of America.

9. PERFORMANCE SHARE PLAN

In January 2006, the Board of Directors and Compensation Committee adopted the Overstock.com Performance Share Plan and approved grants to executive officers and certain employees of the Company. The Performance Share Plan provides for a three-year period for the measurement of the Company s attainment of the performance goal described in the form of grant, but at the Company s sole option the Company may make a payment of estimated amounts payable to a plan participant after two years.

The performance goal is measured by growth in economic value, as defined in the plan. The amount of payments due to participants under the plan will be a function of the then current market price of a share of the Company s common stock, multiplied by a percentage dependent on the extent to which the performance goal has been attained, which will be between 0% and 200%. If the growth in economic value is 10% compounded annually or less, the percentage will be 0%. If the growth in economic value is 25% compounded annually, the percentage will be 100%. If the growth in economic value is 40% compounded annually or more, the percentage will be 200%. If the percentage growth is between these percentages, the payment percentage will be determined on the basis of straight line interpolation. Amounts payable under the plan were originally payable in cash. During interim and annual periods prior to the third quarter of 2007, the Company recorded compensation expense based upon the period-end stock price and estimates regarding the ultimate growth in economic value that is expected to occur. These estimates included assumed future growth rates in revenues, gross margins and other factors. If the Company were to use different assumptions, the estimated compensation charges could be significantly different.

An amendment to the Performance Share Plan to allow the Company to make payments in the form of common stock was approved by the shareholders on May 15, 2007. In the third quarter of 2007, the Company engaged an independent third party valuation group to determine the fair value of the awards on the amendment date. Based on the independent third party valuation, the Company made the determination on August 7, 2007 to make the payments in the form of common stock, rather than cash. Therefore, the Company reclassified from their current status as liability awards to equity awards in accordance with FAS 123(R).

The Company reclassified a liability of approximately $1.5 million related to performance share awards granted prior to the determination to additional-paid-in-capital and recognized additional compensation of approximately $350,000 of compensation expense under the plan in general and administrative expenses for the quarter ended September 30, 2007, based on changes in the Company s estimates regarding the ultimate growth in economic value expected to occur. During the quarter ended September 30, 2006, compensation expense under the Plan was reduced by $100,000. For the nine months ended September 30, 2006 and 2007, compensation expense under the plan totaled $800,000 and $1.0 million, respectively. As of September 30, 2007, the Company has recognized $1.9 million in total compensation expense under the plan.

10. BORROWINGS

$30.0 million Amended Credit Agreement

On October 18, 2005, the Company entered into a sixth amendment to a credit agreement (Amended Credit Agreement) with Wells Fargo Bank, N.A. The Amended Credit Agreement provides a revolving line of credit to the Company of up to $30.0 million which the Company uses primarily to obtain letters of credit to support inventory purchases. The Amended Credit Agreement expires on December 31, 2007; however, the Company has an option to renew the Amended Credit Agreement annually. Interest on borrowings is payable monthly and accrued at either (i) 1.35% above LIBOR in effect on the first day of an applicable fixed rate term, or (ii) at a fluctuating rate per annum determined by the bank to be one half a percent (0.50%) above daily LIBOR in effect on each business day a change in daily LIBOR is announced by the bank. Unpaid principal, together with accrued and unpaid interest, is due on the maturity date. The Amended Credit Agreement requires the Company to comply with certain covenants, including restrictions on mergers, business combinations or transfer of assets. The Company was in compliance with these covenants at September 30, 2007.

Borrowings and outstanding letters of credit under the Amended Credit Agreement are required to be completely collateralized by cash balances held at Wells Fargo Bank, N.A, and therefore the facility does not provide additional liquidity to the Company.

At September 30, 2007, no amounts were outstanding under the Amended Credit Agreement, and Letters of Credit totaling $2.7 million were issued on behalf of the Company.

$40.0 million WFRF Agreement

On December 12, 2005, the Company entered into a Loan and Security Agreement (the WFRF Agreement) with Wells Fargo Retail Finance, LLC and related security agreements and other agreements described in the WFRF Agreement.

The WFRF Agreement provides for advances to the Company and for the issuance of letters of credit for its account of up to an aggregate maximum of $40.0 million. The Company has the right to increase the aggregate maximum amount available under the facility to up to $50.0 million during the first two years of the facility. The amount actually available to the Company may be less and may vary from time to time, depending on, among other factors, the amount of its eligible inventory and receivables. The Company s obligations under the WFRF Agreement and all related agreements are collateralized by all or substantially all of the Company s and its subsidiaries assets. The Company s obligations under the WFRF Agreement are cross-collateralized with its assets pledged under its $30.0 million credit facility with Wells Fargo Bank, N.A. The term of the WFRF Agreement is three years, expiring on December 12, 2008. The WFRF Agreement contains standard default provisions.

Advances under the WFRF Agreement bear interest at either (a) the rate announced, from time to time, within Wells Fargo Bank, N.A. at its principal office in San Francisco as its prime rate or (b) a rate based on LIBOR plus a varying percentage between 1.25% and 1.75%; however, the annual interest rate on advances under the WFRF Agreement will be at least 3.50%. The WFRF Agreement includes affirmative covenants as well as negative covenants that prohibit a variety of actions without the lender s approval, including covenants that limit the Company s ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another person, (d) sell assets, (e) change its name or the name of any of its subsidiaries, (f) make certain changes to its business, (g) optionally prepay, acquire or refinance indebtedness, (h) consign inventory, (i) pay dividends on, or purchase, acquire or redeem shares of, its capital stock, (j) change its method of accounting, (k) make investments, (l) enter into transactions with affiliates, or (m) store any of its inventory or equipment with third parties. The Company was in compliance with these covenants as of September 30, 2007. At September 30, 2007, no amounts were outstanding and availability under the WFRF Agreement was $8.8 million.

Capital leases

The Company leases certain software and computer equipment under three non-cancelable capital leases that expire at various dates through 2008.

Software and equipment relating to the capital leases totaled $19.8 million at December 31, 2006 and September 30, 2007, with accumulated amortization of $12.4 million and $17.4 million at those respective dates.

Depreciation of assets recorded under capital leases was $1.8 million and $1.6 million for the three months ended September 30, 2006 and 2007, respectively. For the nine months ended September 30, 2006 and 2007, depreciation of assets recorded under

capital leases was $5.4 million and $4.9 million, respectively.

Future minimum lease payments under capital leases are as follows (in thousands):

Twelve months ending September 30,		
2008	$	4,091
Less: amount representing interest		(290)
Present value of capital lease obligations		3,801
Less: current portion		(3,801)
Capital lease obligations, non-current	$	

11. 3.75% CONVERTIBLE SENIOR NOTES

In November 2004, the Company completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes). Proceeds to the Company were $116.2 million, net of $3.8 million of initial purchaser s discount and debt issuance costs. The discount and debt issuance costs are being amortized using the straight-line method which approximates the interest method. The Company recorded amortization of discount and debt issuance costs related to this offering totaling $139,000 and $86,000 during the three months ended September 30, 2006 and 2007, respectively. For the nine months ended September 30, 2006 and 2007, amortization of discount and debt issuance costs totaled $417,000 and $258,000, respectively. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

The Senior Notes are convertible at any time prior to maturity into the Company s common stock at the option of the note holders at a conversion price of $76.23 per share or, approximately 1,010,000 shares in aggregate (subject to adjustment in certain events, including stock splits, dividends and other distributions and certain repurchases of the Company s stock, as well as certain fundamental changes in the ownership of the Company). Beginning December 1, 2009, the Company has the right to redeem the Senior Notes, in whole or in part, for cash at 100% of the principal amount plus accrued and unpaid interest. Upon the occurrence of a fundamental change (including the acquisition of a majority interest in the Company, certain changes in the Company s board of directors or the termination of trading of the Company s stock) meeting certain conditions, holders of the Senior Notes may require the Company to repurchase for cash all or part of their notes at 100% of the principal amount plus accrued and unpaid interest.

The indenture governing the Senior Notes requires the Company to comply with certain affirmative covenants, including making principal and interest payments when due, maintaining the Company s corporate existence and properties, and paying taxes and other claims in a timely manner. The Company was in compliance with these covenants at September 30, 2007.

In June and November 2005, the Company retired $33.0 million and $10.0 million of the Senior Notes for $27.9 million and $7.8 million in cash for each respective retirement. As a result of the note retirements in June and November, the Company recognized gains of $4.2 million and $2.0 million, net of the associated unamortized discount of $1.2 million during the quarters ended June 30, 2005 and December 31, 2005, respectively. As of September 30, 2007, $77.0 million of the Senior Notes remained outstanding.

12. COMMITMENTS AND CONTINGENCIES

Commitments

Corporate office space

Through July 2005, the Company leased 43,000 square feet of office space at Old Mill Corporate Center I for its principal executive offices under an operating lease which was originally scheduled to expire in January 2007. Beginning July 2005, this lease was terminated and replaced with a lease for approximately 154,000 rentable square feet in the Old Mill Corporate Center III in Salt Lake City, Utah for a term of ten years.

The Company and Old Mill Corporate Center III, LLC (the Lessor) entered into a Tenant Improvement Agreement (the OMIII Agreement) relating to the office building in February 2005. The OMIII Agreement sets forth the terms on which the Company paid the costs of certain improvements to the leased office space. The amount of the costs was approximately $2.0 million. The OMIII Agreement also required the Company to provide a letter of credit in the amount of $500,000 to the Lessor to provide funds for the removal of certain improvements upon the termination of the lease.

During the fourth quarter 2006, the Company commenced implementation of a facilities consolidation and restructuring program. The Company recorded a liability of $450,000 for the costs to dismantle and dispose of an escalator system and to return the leased facilities to their original condition under the Tenant Improvement Agreement and incurred additional amortization expense in connection with the revised useful life of certain leasehold improvements. In the second quarter of 2007, the Company abandoned and began marketing for sub-lease office and data center space in the current corporate office facilities and recorded an additional $2.4 million of restructuring charges related to accelerated amortization of leasehold improvements located in the abandoned office and data center space and $2.0 million of other restructuring charges, primarily related to consolidation of office

space in the current corporate office facilities, relocation of a data center and employee severance (see Note 3).

Logistics and warehouse space

In July 2004, the Company entered into a logistics service agreement (the Logistics Agreement) wherein the handling, storage and distribution of some of the Company s prepackaged products is performed by a third party. The Logistics Agreement and subsequent amendment set forth terms on which the Company paid various fixed fees based on square feet of storage and various variable costs based on product handling costs for a term of five years.

In December 2005, the Company entered into a warehouse facilities lease agreement (the License Agreement) to license approximately 400,000 square feet of warehouse space in Indiana. The License Agreement was subsequently amended, reducing the amount of lease space to approximately 300,000 and extending the term to 2011.

In the first quarter of 2007, the Company terminated the Logistics Agreement and gave notice of intent to sublease the Indiana warehouse facilities under the License Agreement. During the second quarter of 2007, the Company reached an agreement to terminate the Indiana warehouse facilities lease effective August 15, 2007 for $1.9 million (see Note 3).

The Company leases 561,000 square feet for its warehouse facilities in Utah under operating leases which expire in August 2012. The Company has also temporarily leased an additional 251,000 square feet of warehouse space in Utah under operating leases for the seasonal increase in inventory during the fourth quarter of 2007.

Co-location data center

In July 2005, the Company entered into a Co-location Center Agreement (the Co-location Agreement) to build out and lease 11,289 square feet of space at Old Mill Corporate Center II for an IT co-location data center. The Co-location Agreement set forth the terms on which the Lessor would incur the costs to build out the IT co-location data center and the Company would commence to lease the space upon its completion for a term of ten years. In November 2006 however, the Company made the determination to consolidate its facilities and to not occupy the IT co-location data center, and the Co-location Agreement was terminated effective December 28, 2006 (see Note 3).

In December 2006, the Company entered into a Co-location Data Center Agreement (the OM I Co-location Agreement) to lease 3,999 square feet of space at Old Mill Corporate Center I for an IT co-location data center to allow the Company to consolidate other IT data center facilities at the Old Mill Corporate Center II and at the Company s current corporate offices facilities.

Operating leases

In June 2005 and 2006, the Company entered into non-cancelable operating leases for certain computer equipment expiring in April 2008 and June 2008, respectively. It is expected that such leases will be renewed by exercising purchase options or replaced by leases of other computer equipment.

Minimum future payments under these leases are as follows (in thousands):

Twelve months Ending September 30,		
2008	$	8,422
2009		6,228
2010		6,117
2011		5,764
2012		5,812
Thereafter		12,261