

OVERSTOCK.COM, INC  
Form 10-Q  
October 27, 2011  
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**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, 2011

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-49799

**OVERSTOCK.COM, INC.**

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(Exact name of registrant as specified in its charter)

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

**87-0634302**  
(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  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

There were 23,276,043 shares of the Registrant's common stock, par value \$0.0001, outstanding on October 14, 2011.

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Table of Contents**PART 1. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)****Overstock.com, Inc.****Consolidated Balance Sheets (Unaudited)****(in thousands)**

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 79,138	\$ 124,021
Restricted cash	2,383	2,542
Accounts receivable, net	8,445	13,560
Inventories, net	19,210	32,114
Prepaid inventories, net	1,415	2,082
Prepays and other assets	15,254	11,651
Total current assets	125,845	185,970
Fixed assets, net	27,085	27,800
Goodwill	2,784	2,784
Other long-term assets, net	2,261	1,405
Total assets	\$ 157,975	\$ 217,959
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 42,552	\$ 67,311
Accrued liabilities	37,684	40,751
Deferred revenue	21,180	24,027
Convertible senior notes, net of debt discount - \$0 and \$141		34,484
Finance obligations, current	5,844	3,922
Capital lease obligations, current	185	729
Total current liabilities	107,445	171,224
Capital lease obligations, non-current	3	113
Finance obligations, non-current	14,485	12,219
Long-term debt	17,000	
Other long-term liabilities	3,034	3,175
Total liabilities	141,967	186,731
Commitments and contingencies (Note 5)		
Redeemable common stock, \$0.0001 par value:		
Outstanding - 0 and 46		570
Stockholders equity:		
Preferred stock, \$0.0001 par value: Authorized shares - 5,000 Issued and outstanding shares - none		
Common stock, \$0.0001 par value Authorized shares - 100,000 Issued shares - 26,237 and 25,877 Outstanding shares - 23,277 and 23,015		
	2	2

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Additional paid-in capital	352,728	349,747
Accumulated deficit	(258,356)	(242,327)
Treasury stock:		
Shares at cost - 2,960 and 2,862	(78,366)	(76,764)
Total stockholders' equity	16,008	30,658
Total liabilities and stockholders' equity	\$ 157,975	\$ 217,959

See accompanying notes to consolidated financial statements.

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## Overstock.com, Inc.

## Consolidated Statements of Operations (Unaudited)

(in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Revenue, net				
Direct	\$ 34,749	\$ 47,508	\$ 116,353	\$ 140,458
Fulfillment partner	204,989	197,912	623,847	600,545
Total net revenue	239,738	245,420	740,200	741,003
Cost of goods sold				
Direct(1)	32,472	43,174	105,733	124,192
Fulfillment partner	168,893	160,868	506,240	486,583
Total cost of goods sold	201,365	204,042	611,973	610,775
Gross profit	38,373	41,378	128,227	130,228
Operating expenses:				
Sales and marketing(1)	13,822	15,626	42,902	44,084
Technology(1)	17,171	14,186	50,639	42,312
General and administrative(1)	15,321	14,742	50,032	44,151
Restructuring				(136)
Total operating expenses	46,314	44,554	143,573	130,411
Operating loss	(7,941)	(3,176)	(15,346)	(183)
Interest income	23	55	121	111
Interest expense	(662)	(668)	(1,968)	(2,230)
Other income, net	553	387	962	1,410
Loss before income taxes	(8,027)	(3,402)	(16,231)	(892)
Provision (benefit) for income taxes	(240)	(44)	(202)	78
Net loss	\$ (7,787)	\$ (3,358)	\$ (16,029)	\$ (970)
Deemed dividend related to redeemable common stock		(23)	(12)	(99)
Net loss attributable to common shares	\$ (7,787)	\$ (3,381)	\$ (16,041)	\$ (1,069)
Net loss per common share basic:				
Net loss attributable to common shares basic	\$ (0.33)	\$ (0.15)	\$ (0.69)	\$ (0.05)
Weighted average common shares outstanding basic	23,276	23,060	23,253	23,006
Net loss per common share diluted:				
Net loss attributable to common shares diluted	\$ (0.33)	\$ (0.15)	\$ (0.69)	\$ (0.05)
Weighted average common shares outstanding diluted	23,276	23,060	23,253	23,006

(1) Includes stock-based compensation as follows (Note 8):

Cost of goods sold direct	\$ 47	\$ 55	\$ 134	\$ 157
Sales and marketing	80	152	289	454
Technology	171	272	534	794
General and administrative	403	807	1,454	2,365
Total	\$ 701	\$ 1,286	\$ 2,411	\$ 3,770

See accompanying notes to consolidated financial statements.



Table of Contents**Overstock.com, Inc.****Consolidated Statements of Stockholders' Equity****(Unaudited)****(in thousands)**

	Common stock			Additional Paid-in Capital	Accumulated Deficit	Treasury stock		Total
	Shares	Amount				Shares	Amount	
Balances at December 31, 2010	25,877	\$ 2	\$	349,747	\$ (242,327)	2,862	\$ (76,764)	\$ 30,658
Stock-based compensation to employees and directors				2,411				2,411
Common stock issued upon vesting of restricted stock	314							
Purchase of treasury stock						98	(1,602)	(1,602)
Lapse of rescission rights of redeemable common stock (Note 9)	46			582				582
Deemed dividend related to redeemable common stock (Note 9)				(12)				(12)
Net loss					(16,029)			(16,029)
Balance at September 30, 2011	26,237	\$ 2	\$	352,728	\$ (258,356)	2,960	\$ (78,366)	\$ 16,008

See accompanying notes to consolidated financial statements.



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## Overstock.com, Inc.

## Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Nine months ended September 30,		Twelve months ended September 30,	
	2011	2010	2011	2010
<b>Cash flows from operating activities:</b>				
Net income (loss)	\$ (16,029)	\$ (970)	\$ (1,170)	\$ 11,757
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	12,472	10,471	16,581	13,312
Realized loss on marketable securities				9
(Gain) Loss on disposition of fixed asset		14	(14)	13
Stock-based compensation to employees and directors	2,411	3,770	3,697	5,092
Amortization of debt discount	77	306	162	367
(Gain) loss from early extinguishment of debt	54	(346)	54	(346)
Restructuring reversals		(136)	(433)	(136)
Changes in operating assets and liabilities:				
Restricted cash	159	1,872	159	1,743
Accounts receivable, net	5,115	3,252	(57)	1,012
Inventories, net	12,904	(11,018)	15,183	(12,358)
Prepaid inventories, net	667	168	1,296	905
Prepays and other assets	(3,218)	(1,176)	(1,674)	(852)
Other long-term assets, net	12	(474)	271	(514)
Accounts payable	(24,775)	(30,837)	(3,253)	12,056
Accrued liabilities	(3,507)	(6,649)	567	1,098
Deferred revenue	(2,847)	85	430	1,550
Other long-term liabilities	205	(54)	(55)	(54)
Net cash provided by (used in) operating activities	(16,300)	(31,722)	31,744	34,654
<b>Cash flows from investing activities:</b>				
Purchases of marketable securities	(119)	(100)	(155)	(100)
Purchases of intangible assets	(7)	(380)	(23)	(380)
Sale of marketable securities prior to maturity				(9)
Investment in precious metals		(1,657)		(1,657)
Expenditures for fixed assets, including internal-use software and website development	(6,344)	(19,317)	(7,538)	(20,583)
Net cash used in investing activities	(6,470)	(21,454)	(7,716)	(22,729)
<b>Cash flows from financing activities:</b>				
Payments on capital lease obligations	(654)	(422)	(722)	(472)
Capitalized financing costs	(121)		(121)	(245)
Proceeds from finance obligations	1,429	14,577	3,235	14,577
Payments on finance obligations	(3,390)		(4,231)	
Paydown on direct financing arrangement	(160)	(146)	(211)	(205)
Proceeds from long-term debt	17,000		17,000	
Payments to retire convertible senior notes	(34,615)	(24,865)	(34,615)	(24,865)
Purchase of redeemable stock			(26)	
Purchase of treasury stock	(1,602)	(821)	(1,606)	(828)
Exercise of stock options		1,504	(1)	1,530
Net cash used in financing activities	(22,113)	(10,173)	(21,298)	(10,508)
Net increase (decrease) in cash and cash equivalents	(44,883)	(63,349)	2,730	1,417
Cash and cash equivalents, beginning of period	124,021	139,757	76,408	74,991

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Cash and cash equivalents, end of period	\$	79,138	\$	76,408	\$	79,138	\$	76,408
<b>Supplemental disclosures of cash flow information:</b>								
<b>Cash paid during the period:</b>								
Interest paid	\$	1,814	\$	1,598	\$	2,750	\$	2,898
Taxes paid		260		187		260		187
<b>Non-cash investing and financing activities:</b>								
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	\$	270	\$	910	\$	155	\$	910
Equipment acquired under finance obligations		5,077				5,676		
Equipment and software acquired under capital lease obligations				6				
Lapse of rescission rights of redeemable stock		582				842		
Issuance of common stock from treasury for 401(k) matching contribution				87				256

See accompanying notes to consolidated financial statements.

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**Overstock.com, Inc.**

**Notes to Unaudited Consolidated Financial Statements**

**1. BASIS OF PRESENTATION**

As used herein, Overstock.com, O.co, we, our and similar terms include Overstock.com, Inc. and its subsidiaries, unless the context indicates otherwise. The accompanying unaudited consolidated financial statements have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ) 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 our audited annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2010. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of results for the interim periods presented. Preparing financial statements requires us 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 our best knowledge of current events and actions that we 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, 2011 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 our accounts and the accounts of our wholly-owned subsidiaries. All 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 estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, investment valuation, receivables valuation, revenue recognition, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets and internally-developed software, goodwill valuation, intangible valuation, income taxes, stock-based compensation, performance-based compensation, restructuring liabilities and contingencies. Actual results could differ materially from those estimates.

*Cash equivalents*

We classify all highly liquid instruments, including money market funds with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents as of September 30, 2011 and December 31, 2010 were \$51.2 million and \$121.8 million, respectively.

*Restricted cash*

We consider cash that is legally restricted and cash that is held as a compensating balance for letter of credit arrangements as restricted cash. At September 30, 2011 and December 31, 2010, restricted cash was \$2.4 million and \$2.5 million, respectively, and was held primarily in money market accounts.

*Fair value of financial instruments*

Our financial instruments, including cash, cash equivalents, accounts receivable, accounts payable and accrued liabilities are carried at cost, which approximates their fair value because of the short-term maturity of these instruments. We are party to a Financing and Security Agreement with U.S. Bank dated December 22, 2009 (as amended on August 19, 2011, the Financing Agreement ). Our Financing Agreement is also carried at face value, which approximates its fair value due to its variable interest rate.

We account for our assets and liabilities using a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs have created the following fair-value hierarchy:

- Level 1 Quoted prices for identical instruments in active markets;
- Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

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- Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value.

The fair value of these financial instruments was determined using the following levels of inputs as of September 30, 2011 (in thousands):

	Fair Value Measurements at September 30, 2011:			
	Total	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents and restricted cash -				
Money market mutual funds	\$ 53,543	\$ 53,543	\$	\$
Trading securities held in a rabbi trust				
(1)	246	246		
Total assets	\$ 53,789	\$ 53,789	\$	\$
<b>Liabilities:</b>				
Deferred compensation accrual rabbi				
trust (3)	249	249		
Total liabilities	\$ 249	\$ 249	\$	\$

The fair value of these financial instruments was determined using the following levels of inputs as of December 31, 2010 (in thousands):

	Fair Value Measurements at December 31, 2010:			
	Total	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents and restricted cash -				
Money market mutual funds	\$ 124,313	\$ 124,313	\$	\$
Trading securities held in a rabbi trust				
(1)	148	148		
Total assets	\$ 124,461	\$ 124,461	\$	\$
<b>Liabilities:</b>				
Restructuring accrual (2)	\$ 1,797	\$	\$	\$ 1,797
Deferred compensation accrual rabbi				
trust (3)	154	154		
Total liabilities	\$ 1,951	\$ 154	\$	\$ 1,797

(1) Trading securities held in a rabbi trust are included in Other current and long-term assets in the consolidated balance sheets (Note 11 Employee Retirement Plan).

(2) The fair value was determined based on the income approach, in which we used internal cash flow projections over the life of the underlying lease agreements discounted based on a credit adjusted risk-free rate of return. See the Level 3 roll forward related to the restructuring accrual at

(Note 3 Restructuring Expense).

(3) Non qualified deferred compensation for rabbi trust is included in Accrued liabilities and Other long-term liabilities in the consolidated balance sheets (Note 11 Employee Retirement Plan).

The estimated fair value of our 3.75% Convertible Senior Notes due 2011 ( Senior Notes ) outstanding at December 31, 2010 was \$33.2 million on a carrying value of \$34.5 million. The fair value of the Senior Notes was derived using a convertible debt pricing model with observable market inputs, which include stock price, dividend payments, borrowing costs, equity volatility, interest rates and interest spread. On September 21, 2011 we retired all of the outstanding Senior Notes (Note 4 Borrowings).

*Restricted investments*

In December 2009, we implemented a Non Qualified Deferred Compensation Plan (the NQDC Plan ) for senior management (Note 11 Employee Retirement Plan). Deferred compensation amounts are invested in mutual funds held in a rabbi trust and are restricted for payment to the participants of the NQDC Plan. We account for our investments held in the trust in accordance with Accounting Standards Codification ( ASC ) No. 320 *Investments Debt and Equity Securities* . The investments held in the trust are classified as trading securities. The fair value of the investments held in the trust totaled \$246,000 at September 30, 2011 and are included in Other current and long-term assets in the consolidated balance sheets. Our gains and losses on these investments were immaterial for the three and nine months ended September 30, 2011 and 2010.

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*Accounts receivable*

Accounts receivable consist primarily of trade amounts due from customers and from uncleared credit card transactions at period end. Accounts receivable are recorded at invoiced amounts and do not bear interest.

*Allowance for doubtful accounts*

From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We perform credit evaluations of our business customers' financial condition and payment history and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was \$657,000 and \$2.0 million at September 30, 2011 and December 31, 2010, respectively. The decrease in the allowance for doubtful accounts was primarily due to write-offs of accounts receivable during the nine months ended September 30, 2011, which had no significant effect on results of operations for the period as most of the items had been previously reserved.

*Concentration of credit risk*

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At September 30, 2011 and December 31, 2010, two banks held the majority of our cash and cash equivalents. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of cash equivalents and receivables. We invest our cash primarily in money market securities which are uninsured.

Our accounts receivable are derived primarily from revenue earned from customers located in the United States. We maintain an allowance for doubtful accounts based upon the expected collectability of accounts receivable.

*Valuation of inventories*

Inventories, consisting of merchandise purchased for resale, are accounted for using a standard costing system which approximates the first-in-first-out ( FIFO ) method of accounting, and are valued at the lower of cost or market. We write down our inventory for estimated obsolescence and to lower of cost or market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory allowance represents the new cost basis of such products. Reversal of the allowance is recognized only when the related inventory has been sold or scrapped.

*Prepaid inventories, net*

Prepaid inventories represent inventories paid for in advance of receipt. Prepaid inventories at September 30, 2011 and December 31, 2010 were \$1.4 million and \$2.1 million, respectively.

*Prepays and other assets*

Prepays and other assets represent expenses paid prior to receipt of the related goods or services, including advertising, maintenance, packaging, insurance, and other miscellaneous costs, as well as investments in precious metals. Total prepays and other assets at September 30, 2011 and December 31, 2010 were \$15.3 million and \$11.7 million, respectively.

*Fixed assets*

Fixed assets, which include assets such as technology infrastructure, internal-use software, website development, furniture and fixtures and leasehold improvements, are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the related assets or the term of the related capital lease, whichever is shorter, as follows:

	<b>Life (years)</b>
Computer software	2-3
Computer hardware	3
Furniture and equipment	3-5

Leasehold improvements are amortized over the shorter of the term of the related leases or estimated useful lives.



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Depreciation and amortization expense is classified within the corresponding operating expense categories on the consolidated statements of operations as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Cost of goods sold - direct	\$ 137	\$ 277	\$ 583	\$ 912
Technology	3,766	3,296	11,009	8,930
General and administrative	307	253	880	629
Total depreciation and amortization, including internal-use software and website development	\$ 4,210	\$ 3,826	\$ 12,472	\$ 10,471

*Internal-use software and website development*

Included in fixed assets is the capitalized cost of internal-use software and website development, including software used to upgrade and enhance our Website and processes supporting our business. We capitalize costs incurred during the application development stage of internal-use software and amortize these costs over the estimated useful life of two to three years. Costs incurred related to design or maintenance of internal-use software are expensed as incurred.

During the three months ended September 30, 2011 and 2010, we capitalized \$2.3 million and \$2.4 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was \$2.1 million and \$1.6 million for those respective periods. During the nine months ended September 30, 2011 and 2010, we capitalized \$7.8 million and \$7.5 million, respectively, of such costs and had amortization of \$6.1 million and \$4.7 million for those respective periods.

*Revenue recognition*

We derive revenue primarily from two sources: direct revenue and fulfillment partner revenue, including listing fees and commissions collected from products being listed and sold through the Auctions tab, which we removed from our site in July 2011, advertisement revenue derived from our real estate listing business, which we removed from our site on June 30, 2011, from our cars listing business, and from advertising on our shopping, vacations and insurance pages. We have organized our operations into two principal segments based on the primary source of revenue: direct revenue and fulfillment partner revenue (see Note 10 Business Segments).

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and therefore recognized as revenue at the end of the period. The delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the type of shipping carrier (as carriers have different in-transit times); (ii) the fulfillment source (either our warehouses or those of our fulfillment partners); (iii) the delivery destination; and

(iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment.

We evaluate the criteria outlined in ASC Topic 605-45, *Principal Agent Considerations*, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. When we are the primary obligor in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not the primary obligor in the transaction and amounts earned are determined using a fixed percentage, revenue is recorded on a net basis. Currently, the majority of both direct revenue and fulfillment partner revenue is recorded on a gross basis, as we are the primary obligor. We present revenue net of sales taxes.

We periodically provide incentive offers to our customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off future purchases, and other similar offers. Current discount offers, when used by customers, are treated as a reduction of revenue.

*Direct revenue*

Direct revenue consists of merchandise sold through our Website to individual consumers and businesses that is fulfilled from our leased warehouses.

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*Fulfillment partner revenue*

Fulfillment partner revenue consists of merchandise sold through our Website and shipped by fulfillment partners directly to consumers and businesses from warehouses maintained by the fulfillment partners.

We operate an online site for listing cars for sale as a part of our Website. The cars listing service allows dealers to list vehicles for sale and allows buyers to review vehicle descriptions, post offers to purchase, and provides the means for purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue from the cars listing business is included in the fulfillment partner segment on a net basis.

We offer a consignment service to suppliers where the suppliers' merchandise is stored in and shipped from our leased warehouses. We pay the consignment supplier upon sale of the consigned merchandise to the consumer. Revenue from consignment service to suppliers is included in fulfillment partner segment on a gross basis.

In April 2011, we began operating a vacations shopping site as part of our website where customers can purchase discount vacation packages. We also earn advertisement revenue from our vacations business. Revenue from the vacations businesses is included in the fulfillment partner segment on a net basis.

In July 2011, we began an insurance shopping service as part of our website where customers can shop for auto and home insurance and compare quotes from various insurance providers. Revenue generated from our insurance shopping site is included in the fulfillment partner segment on a net basis.

We operated an online auction service on our Website. In July 2011, we removed our Marketplace tab from our Website and no longer provide auction services. The financial results and related assets of the online auction service were not significant to our business. The Marketplace tab allowed sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. Except in limited circumstances where our auction site listed returned merchandise, we were not the seller of auction-listed items and had no control over the pricing of those items. Therefore, the listing fees for items sold at auction by sellers were recorded as revenue during the period these items were listed or sold on a net basis. The revenue for the returned merchandise that we sold at auction was recorded on a gross basis. Revenue from the auctions business is included in the fulfillment partner segment.

We operated an online site for listing real estate for sale as a part of our Website. On June 30, 2011, we removed our online site for listing real estate for sale from our Website and no longer provide these real estate listing services. The financial results and related assets of the online site for listing real estate for sale were not significant to our business. The real estate listing service allowed customers to search active listings across the country. Listing categories included foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Revenue from the real estate business is included in the fulfillment partner segment on a net basis.

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In August 2010, we introduced Eziba.com, a private sale website where members can shop exclusive deals on the latest home décor products, jewelry, apparel and accessories from many leading brands. On June 30, 2011, we turned off the Eziba.com website; however, we continue to sell the type of products that were listed on Eziba.com through our websites, O.co and Overstock.com.

### *International business*

We began selling products through our website to customers outside the United States in August 2008. As of September 30, 2011, we were offering products to customers in over 90 countries. We do not have operations outside the United States, and are using a U.S. based third party to provide logistics and fulfillment for all international orders. Revenue generated from the international business is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our leased warehouses or from a fulfillment partner.

Total revenues from International sales were \$2.2 million and \$2.1 million for the three months ended September 30, 2011 and 2010, respectively and \$6.2 million and \$6.6 million for the nine months ended September 30, 2011 and 2010, respectively.

### *Club O loyalty program*

We have a customer loyalty program called Club O for which we sell annual memberships. We record membership fees as deferred revenue and we recognize revenue ratably over the membership period. The Club O loyalty program allows members to earn reward dollars for qualifying purchases made on our Website. We also have a co-branded credit card program (see [Co-branded credit card program](#) below for more information). Co-branded cardholders are also Club O members and earn additional reward dollars for purchases made on our Website, and from other merchants. Reward dollars earned may be redeemed on future purchases made through our Website. Club O reward dollars expire 90 days after the customer's Club O membership expires. We account for these transactions as multiple element arrangements and allocate value to the elements using their relative fair values. We include the value of reward dollars earned in deferred revenue and we record it as a reduction of revenue at the time the reward dollars are earned.

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We recognize revenue for Club O reward dollars when: (i) customers redeem their reward dollars as part of a purchase at our Website, (ii) reward dollars expire or (iii) the likelihood of reward dollars being redeemed by a customer is remote ( reward dollar breakage ). Due to the loyalty program s short history, currently no reward dollar breakage is recognized until the reward dollars expire. However, in the future we plan to recognize such breakage based upon historical redemption patterns.

In instances where customers receive free Club O reward dollars not associated with any purchases, we account for these transactions as sales incentives such as coupons and record a reduction of revenue at the time the reward dollars are redeemed.

*Co-branded credit card program*

In September 2010, we launched a co-branded credit card program with a commercial bank for the issuance of credit cards bearing the Overstock.com brand, under which the bank pays us fees for new accounts and for customer usage of the cards. The agreement also provides for a customer loyalty program offering reward dollars that customers will accrue from card usage and can use to make purchases on our Website (see Club O loyalty program for more information). New account fees are recognized as revenue on a straight-line basis over the estimated life of the credit card relationship. Credit card usage fees are recognized as revenues as actual credit card usage occurs.

*Deferred revenue*

Customer orders are recorded as deferred revenue prior to estimated delivery of products or services. We record amounts received in advance for Club O membership fees as deferred revenue and we recognize it ratably over the membership period. We record Club O reward dollars earned from purchases as deferred revenue at the time they are earned and we recognize it as revenue upon redemption. If reward dollars are not redeemed, we recognize revenue upon expiration. In addition, we also sell gift cards and record related deferred revenue at the time of the sale. We sell gift cards without expiration dates and we recognize revenue upon redemption. If a gift card is not redeemed, we recognize revenue when the likelihood of its redemption becomes remote based on our historical redemption experience. We consider the likelihood of redemption to be remote after 36 months.

*Sales returns allowance*

We inspect returned items when they arrive at our processing facility. We refund the full cost of the merchandise returned and all original shipping charges if the returned item is defective or we or our fulfillment partners have made an error, such as shipping the wrong product.

If the return is not a result of a product defect, our error or our fulfillment partners error and the customer initiates a return of an unopened item within 30 days of delivery, for most products we refund the full cost of the merchandise minus the original shipping charge and actual return shipping fees. However, we reduce refunds for returns initiated more than 30 days after delivery or that are received at our returns processing facility more than 45 days after initial delivery.

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If our customer returns an item that has been opened or shows signs of wear, we issue a partial refund minus the original shipping charge and actual return shipping fees.

Revenue is recorded net of estimated returns. We record an allowance for returns based on current period revenues and historical returns experience. We analyze actual historical returns, current economic trends and changes in order volume and acceptance of our products when evaluating the adequacy of the sales returns allowance in any accounting period.

During the three months ended December 31, 2009, we had a change in estimate for our sales returns allowance that reduced the allowance by approximately \$3.0 million from the prior quarter-end balance and \$3.2 million from the prior year-end balance that was recorded in accordance with ASC 250 *Accounting Changes and Error Corrections* on a prospective basis. The change in estimate for our sales returns allowance had the following impact on our financial results for the three and twelve months ended December 31, 2009 (amounts in thousands, except per share data):

	<b>Three months ended December 31, 2009 (\$ Change)</b>		<b>Twelve months ended December 31, 2009 (\$ Change)</b>	
Revenue, net	\$	2,995	\$	3,208
Gross profit		752		805
Income from continuing operations before income taxes		752		805
Net income		752		805
Net income attributable to common shares - basic	\$	0.04	\$	0.04
Net income attributable to common shares - diluted	\$	0.04	\$	0.03

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The reasons for the change in estimate in the fourth quarter of 2009 were as follows. We made improvements to our information systems during 2008 and 2009 that enabled enhanced reporting and analysis of our returns data used in the estimation process. In early 2009, we implemented initiatives to reduce overall return rates in several of our product categories. In September 2009, we entered into a new master supplier agreement with our fulfillment partners that provided financial incentives for suppliers to reduce returns. These initiatives resulted in a sustained decrease in our product return trends resulting in the change in estimate of sales returns allowance during the three months ended December 31, 2009.

Although we believe that our estimates, assumptions, and judgments are reasonable, actual results have historically differed from our estimates. Based on our actual returns experience through September 30, 2011, had our estimated returns equaled our actual returns, our net loss would have decreased approximately \$1.5 million for the year ended December 31, 2007, our net loss would have increased approximately \$725,000 for the year ended December 31, 2008, and our net income would have decreased approximately \$805,000 for the year ended December 31, 2009. Based on the improvements and initiatives discussed above, we believe that our estimates, assumptions and judgments have improved and our actual product returns have not differed materially from our estimates at December 31, 2010 and June 30, 2011.

The allowance for returns was \$5.6 million and \$11.5 million at September 30, 2011 and December 31, 2010, respectively. The decrease in the sales returns reserve at September 30, 2011 compared to December 31, 2010 is primarily due to decreased revenues mostly due to seasonality.

*Credit card chargeback allowance*

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was \$129,000 and \$125,000 at September 30, 2011 and December 31, 2010, respectively.

*Cost of goods sold*

Cost of goods sold includes product costs, warehousing costs, outbound shipping costs, handling and fulfillment costs, customer service costs and credit card fees, and is recorded in the same period in which related revenues have been recorded. Cost of goods sold, including product cost and other costs and fulfillment and related costs are as follows (in thousands):

Total revenue, net	\$ 239,738	100%	\$ 245,420	100%	\$ 740,200	100%	\$ 741,003	100%
Cost of goods sold								
Product costs and other cost of goods sold	189,074	79%	190,326	77%	573,204	78%	570,353	77%
Fulfillment and related costs	12,291	5%	13,716	6%	38,769	5%	40,422	5%
Total cost of goods sold	201,365	84%	204,042	83%	611,973	83%	610,775	82%

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Gross profit	\$	38,373	16%	\$	41,378	17%	\$	128,227	17%	\$	130,228	18%
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### *Advertising expense*

We expense the costs of producing advertisements the first time the advertising takes place and expense 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 or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled \$11.7 million and \$13.7 million during the three months ended September 30, 2011 and 2010, respectively. For the nine months ended September 30, 2011 and 2010, advertising expenses totaled \$35.9 million and \$38.0 million, respectively. Prepaid advertising, which consists primarily of prepaid advertising airtime, (included in Prepaids and other assets in the accompanying consolidated balance sheets) was \$2.2 million and \$2.9 million at September 30, 2011 and December 31, 2010, respectively.

### *Stock-based compensation*

We measure compensation expense for all outstanding unvested share-based awards at fair value on date of grant and recognize compensation expense over the service period for awards expected to vest on a straight line basis. 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. We consider many factors when estimating expected forfeitures, including types of awards, and historical experience. Actual results may differ substantially from these estimates (see Note 8 Stock-Based Awards).



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*Loss contingencies*

In the normal course of business, we are involved in legal proceedings and other potential loss contingencies. We accrue a liability for such matters when it is probable that a loss has been incurred and the amount can be reasonably estimated. When only a range of possible loss can be estimated, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. We expense legal fees as incurred.

*Restructuring*

Restructuring expenses are primarily comprised of lease termination costs. ASC Topic 420, *Accounting for Costs Associated with Exit or Disposal Activities*, requires that when an entity ceases using a property that is leased under an operating lease before the end of the contractual term, the termination costs should be recognized and measured at fair value when the entity ceases using the facility. Key assumptions in determining the restructuring expenses include the terms that may be negotiated to exit certain contractual obligations (see Note 3 Restructuring Expense).

*Income taxes*

Income taxes are accounted for under the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. The effect on deferred tax assets and liabilities related to a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred tax assets are evaluated for future realization and are reduced by a valuation allowance to the extent that it is more likely than not that the deferred tax asset will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred assets including expectations of future taxable income, the carry-forward periods available for tax reporting purposes, the reversals of our deferred tax liabilities and other relevant factors. At September 30, 2011 and December 31, 2010, we have a full valuation allowance against our deferred tax assets, net of expected reversals of existing deferred tax liabilities, as we believe it is more likely than not that these benefits will not be realized. Significant judgment is required in making this assessment, and it is very difficult to predict when, if ever, our assessment may conclude that the remaining portion of the deferred tax assets are realizable.

*Comprehensive income (loss)*

We had no items of comprehensive income or loss for the three or nine months ended September 30, 2011 and 2010. Accordingly, net income or loss for these periods is the same as comprehensive income or loss.

*Earnings (loss) 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, comprising incremental common shares issuable upon the exercise of stock options, restricted stock awards and convertible senior notes are included in the calculation of diluted earnings (loss) per common share to the extent such shares are dilutive.

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

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	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net loss	\$ (7,787)	\$ (3,358)	\$ (16,029)	\$ (970)
Deemed dividend related to redeemable common stock		(23)	(12)	(99)
Net loss attributable to common shares	\$ (7,787)	\$ (3,381)	\$ (16,041)	\$ (1,069)
Net loss per common share basic:				
Net loss attributable to common shares basic	\$ (0.33)	\$ (0.15)	\$ (0.69)	\$ (0.05)
Weighted average common shares outstanding basic	23,276	23,060	23,253	23,006
Effect of dilutive securities:				
Stock options and restricted stock awards				
Convertible senior notes				
Weighted average common shares outstanding diluted	23,276	23,060	23,253	23,006
Net loss attributable to common shares diluted	\$ (0.33)	\$ (0.15)	\$ (0.69)	\$ (0.05)

The following shares were excluded from the calculation of diluted shares outstanding as their effect would have been anti-dilutive (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Stock options and restricted stock awards	985	1,242	985	1,242
Convertible senior notes		454		454

*Accounting pronouncements issued not yet adopted*

In September 2011, the FASB issued accounting pronouncement No. 2011-08, Intangibles—Goodwill and Other (FASB ASC Topic 350) that will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The provisions for this pronouncement are effective for fiscal years, and interim periods beginning after December 15, 2011, with early adoption permitted. We will adopt this pronouncement for our fiscal year beginning January 1, 2012. We do not expect this pronouncement to have a material effect on our consolidated financial statements.

**3. RESTRUCTURING EXPENSE**

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During the fourth quarter of 2006, we began 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.

Restructuring liabilities along with charges (credits) to expense and payments associated with the facilities consolidation and restructuring program are as follows as of September 30, 2011 (in thousands):

	<b>Balance 12/31/2010</b>	<b>Accretion Expense</b>	<b>Net Cash Payments</b>	<b>Balance 9/30/2011</b>
Lease and contract termination	\$ 1,797	\$ 128	\$ (353)	\$ 1,572

There were no restructuring charges or reversals during the three and nine months ended September 30, 2011. During the three and nine months ended September 30, 2010, there were no restructuring charges. During the nine months ended September 30, 2010 we reversed \$136,000 of lease termination costs liability due to changes in our estimate of sublease income, primarily as a result of entering into a sublease agreement for previously vacant space.

#### 4. BORROWINGS

##### *U.S. Bank Financing Agreements*

We are a party to a Financing and Security Agreement with U.S. Bank dated December 22, 2009 (as amended on August 19,

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2011, the Financing Agreement ). The maximum credit potentially available under the revolving facility is \$20 million. Our obligations under the Financing Agreement and all related agreements are secured by all or substantially all of our assets, excluding our interest in certain litigation. Subject to certain exceptions, the full amount of the revolving facility is expected to be available to us as long as \$30 million in the aggregate (which amount includes any minimum liquidity required under the Master Lease Agreement) is maintained on deposit with U.S. Bank. The obligation of U.S. Bank to make advances under the Financing Agreement is subject to the conditions set forth in the Financing Agreement. Concurrent to signing the amendment to the Financing Agreement, we also obtained a waiver from U.S. Bank, which prohibited us from forming any subsidiaries, in regards to our formed subsidiary Overstock.com Services, Inc.

The stated termination date of the Financing Agreement is December 31, 2012. The maximum amount potentially available under the Financing Agreement is \$20 million, limited to \$3 million for cash-collateralized revolving loans and other financial accommodations, and \$17 million for advances supported by our non-cash collateral. As permitted by the Financing Agreement, during the quarter ended September 30, 2011, we used the entire \$17 million available for advances supported by our non-cash collateral to fund the redemption of our then-outstanding Senior Convertible Notes due December 1, 2011. Our obligations under the Financing Agreement and all related agreements are secured by all or substantially all of our assets, excluding our interest in certain litigations.

Advances under the amended Financing Agreement bear interest at one-month LIBOR plus 2.5%. The interest rate for borrowings under the amended Financing Agreement was 2.75% at September 30, 2011. We have also entered into an interest rate cap agreement with U.S. Bank with an effective date of October 1, 2011 limiting our exposure for one-month LIBOR at 0.5% for the term of the Financing Agreement.

In addition to the Financing Agreement, we are a party to a Master Lease Agreement and a Financial Covenants Rider and related documents (collectively, the Master Lease Agreement ) with U.S. Bancorp Equipment Finance, Inc. Technology Finance Group ( Lessor ), an affiliate of U.S. Bank National Association, which requires us to maintain a minimum liquidity (defined as cash plus marketable securities) of \$30 million in the aggregate (which amount includes any minimum liquidity required under the Financing Agreement) at all times on deposit with U.S. Bank National Association until all amounts owed under the Master Lease Agreement are paid in full. The Master Lease Agreement provides that we are permitted to withdraw the funds on deposit with U.S. Bank National Association at our discretion, although our failure to maintain a minimum liquidity of \$30 million would be an Event of Default under the Master Lease Agreement, and an Event of Default under the Master Lease Agreement would cause an Event of Default under the Financing Agreement. Consequently, our failure to keep at least \$30 million on deposit in certain accounts with U.S. Bank would constitute a triggering event under the Financing Agreement. If a triggering event occurs, we would become subject to financial covenants (i) limiting our capital expenditures to \$20 million annually, and (ii) requiring us to maintain a Financing Agreement defined fixed charges coverage ratio of at least 1.10 to 1.00 as of the end of any fiscal quarter for the period of the prior four quarters. The occurrence of a triggering event could also result in a decrease in the amount available to us under the non cash-collateralized portion of the facility, as availability would then depend, in part, on the Borrowing Base (as defined in the Financing Agreement). At September 30, 2011, we had \$30.0 million in compensating cash balances held at U.S. Bank.

The Financing Agreement includes affirmative covenants and negative covenants that prohibit a variety of actions without the approval of U.S. Bank, including, without limitation, covenants that (subject to certain exceptions) limit our ability to (a) incur or guarantee debt or enter into indemnity agreements, (b) create or permit liens, (c) enter into any merger or consolidation or purchase or otherwise acquire all or substantially all of the assets of another person or the assets comprising any line of business or business unit of another person, (d) except for permitted acquisitions, purchase the securities of, create, invest in, or form any subsidiary or other entity, (e) make loans or advances, (f) purchase, acquire or redeem shares of our capital stock or other securities, (g) change our capital structure or issue any new class of capital stock, (h) change our business objectives, purposes or operations in a manner which could reasonably be expected to have a material adverse effect, (i) change our fiscal year, (j) enter into transactions with affiliates, (k) sell assets except for the sale of inventory in the ordinary course of business, (l) permit judgments to be rendered against us in excess of certain limits or having specified effects, depending in part on whether a triggering event has occurred or would occur, (m) take certain actions regarding our receivables, and (n) take certain actions regarding our inventory.

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With certain exceptions, a termination fee of up to 0.75% of the non cash-collateralized portion of the facility is payable by us if we terminate the facility prior to its stated termination date.

The obligation of U.S. Bank to make advances under the Financing Agreement is subject to the conditions set forth in the Financing Agreement. In addition to the transactions contemplated by the Amendments and the Financing Agreement, we are a party to the Master Lease Agreement described herein, and use or intend to utilize other commercial banking services from U.S. Bank or its affiliates, including treasury management services, investment management services, and purchase card services.

Amounts outstanding under the Financing Agreement at September 30, 2011 and December 31, 2010 were \$17.0 million and zero, respectively. Letters of credit totaling \$2.4 million and \$2.4 million, respectively, were issued on our behalf collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets.

On September 17, 2010 we entered into a Master Lease Agreement and a Financial Covenants Rider (collectively, the Master Lease Agreement ) with U.S. Bancorp Equipment Finance, Inc.-Technology Finance Group ( Lessor ), an affiliate of U.S. Bank. Under

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the Master Lease Agreement we entered into four separate leases, pursuant to which we sold certain information technology hardware (the IT Assets ) to Lessor, which were simultaneously leased back for a period of 48 months and financed certain software licenses for a period of 48 months for proceeds totaling approximately \$16.4 million. Subsequently, we entered into eleven additional leases; whereby we leased \$8.2 million in IT Assets and financed certain software licenses for a period of 48 months directly from the Lessor. We have the right to repurchase the IT Assets at the end of the 48-month term for \$1.00. In addition, we have the right to repurchase the IT Assets and terminate the Master lease Agreement twelve months following the initial term, or under certain situations where there is a change in control of the Lessor, defined as a circumstance where the Lessor merges, or sells substantially all of its assets, or another entity acquires more than 25% of the ownership interests of Lessor or Lessor's parent. Payments on the Master Lease Agreement are due monthly. The weighted average effective interest rate under the Master Lease Agreement is 6.29%. We have accounted for the Master Lease Agreement as a financing transaction and amounts owed are included in Finance Obligations, current and non-current in the consolidated balance sheets. We recorded no gain or loss on these leasing transactions.

The Master Lease Agreement requires us to maintain a minimum Total Fixed Charge Coverage annualized ratio of at least 1.20:1.00, based on operating results, measured at the end of each fiscal quarter. Total Fixed Charge Coverage is defined as our EBITDAR (which is defined to mean earnings before interest expense, tax expense or benefit, depreciation expense, amortization expense and rent (defined as payments for real property leases and other operating leases)) less the aggregate amount of federal, state, local and/or foreign income taxes accrued less declared dividends less 50% of depreciation expense divided by our (rental expense plus interest expense plus required principal payments including capitalized leases, excluding principal payments made for retirements of Senior Notes, on a trailing twelve-month basis). The annualized ratio shall be based on a four-quarter, rolling average of the current fiscal quarter and the immediately preceding three fiscal quarters.

U.S. Bank has the contractual right to demand payment of all amounts outstanding under the Financing Agreement and Master Lease Agreement if we fail to comply with certain loan covenants. At September 30, 2011 our Total Fixed Charge Coverage annualized ratio was in excess of the required 1.20:1.00. However, based on the results for the first three quarters of 2011, it is likely that we will be out of compliance with the Total Fixed Charge Coverage ratio at December 31, 2011 unless current trends improve substantially. We have held initial and collegial discussions with U.S. Bank regarding this potential non-compliance.

Fixed assets included assets under finance obligations of \$21.6 million and \$16.0 million and accumulated depreciation of \$8.4 million and \$3.7 million at September 30, 2011 and December 31, 2010, respectively. Depreciation expense of assets recorded under finance obligations was \$1.7 million and \$952,000 for the three months ended September 30, 2011 and 2010, respectively and \$4.6 million and \$2.3 for the nine months ended September 30, 2011 and 2010, respectively.

Future principal payments of finance obligations as of September 30, 2011 are as follows (in thousands):

<b>Payments due by period</b>	
2011 (remainder)	\$ 1,428
2012	5,942
2013	6,327
2014	5,646
2015	986
	\$ 20,329

*U.S. Bank Commercial Purchasing Card Agreement*

We have a commercial purchasing card (the Purchasing Card ) agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At September 30, 2011, \$1.9 million was outstanding and \$3.1 million was available under the Purchasing Card. At December 31, 2010, \$2.7 million was outstanding and \$2.3 million was available under the Purchasing Card.

*Capital leases*

We have leased certain software and computer equipment, under non-cancelable leases that expire on various dates through 2013.

Fixed assets included assets under capital leases of \$1.7 million and accumulated depreciation of \$1.2 million and \$902,000, at September 30, 2011 and December 31, 2010, respectively. Depreciation expense of assets recorded under capital leases was \$135,000 and \$145,000 for the three months ended September 30, 2011 and 2010, respectively and \$425,000 and \$435,000 for the nine months ended September 30, 2011 and 2010, respectively.

Future payments of capital lease obligations as of September 30, 2011 are as follows (in thousands):



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<b>Payments due by period</b>		
2011 (remainder)	\$	82
2012		115
2013		3
Total minimum lease payments		200
Less: amount representing interest		12
Present value of capital lease obligations		188
Less: current portion		185
Capital lease obligations, non-current	\$	3

*3.75% Convertible Senior Notes*

In November 2004, we completed an offering of \$120.0 million of 3.75% Convertible Senior Notes due 2011 (the *Senior Notes*). Proceeds to us were \$116.2 million, net of \$3.8 million of initial purchaser's discount and debt issuance costs. The discount and debt issuance costs were being amortized using the straight-line method which approximates the effective interest method. We recorded amortization of discount and debt issuance costs related to this offering totaling \$44,000 and \$56,000 during the three months ended September 30, 2011 and 2010, respectively and \$104,000 and \$190,000 during the nine months ended September 30, 2011 and 2010, respectively. Interest on the Senior Notes was payable semi-annually on June 1 and December 1 of each year. The Senior Notes were scheduled to mature on December 1, 2011 and were unsecured and ranked 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.

We retired all of the Senior Notes that remained outstanding on September 21, 2011 for \$24.5 million in cash, resulting in a loss of \$26,000 on early extinguishment of debt, net of \$26,000 of associated unamortized discount. We retired \$34.6 million of the Senior Notes during the nine months ended September 30, 2011, for \$34.6 million in cash, resulting in a loss of \$54,000 on early extinguishment of debt, net of \$77,000 of associated unamortized discount. Of the \$34.6 million in Senior Notes retired during the nine months ended September 30, 2011, \$10.1 million were held by Chou Associates Management Inc. ( *Chou* ) or an affiliate of Chou and \$21.7 million were held by Fairfax Financial Holdings Limited ( *Fairfax* ) or an affiliate of Fairfax. Chou and Fairfax are beneficial owners of more than 5% of our common stock. We retired \$16.1 million of the Senior Notes during the three months ended September 30, 2010 for \$15.8 million in cash, resulting in a gain of \$141,000 on early extinguishment of debt, net of \$92,000 of associated unamortized discount. We retired \$25.4 million of the Senior Notes during the nine months ended September 30, 2010 for \$24.9 million in cash, resulting in a gain of \$346,000 on early extinguishment of debt, net of \$158,000 of associated unamortized discount.

As of September 30, 2011 and December 31, 2010, zero and \$34.5 million of the Senior Notes, net of debt discount remained outstanding, respectively.

**5. COMMITMENTS AND CONTINGENCIES***Summary of future minimum lease payments for all operating leases*

Minimum future payments under all operating leases as of September 30, 2011, are as follows (in thousands):

**Payments due by period**

2011 (remainder)	\$	2,333
2012		8,916
2013		8,206
2014		8,404
2015		6,818
Thereafter		1,564
	\$	36,241

Rental expense for operating leases totaled \$2.0 million and \$2.0 million for the three months ended September 30, 2011 and 2010, respectively and \$6.1 million and \$6.0 million for the nine months ended September 30, 2011 and 2010, respectively. Estimated sublease income of \$624,000 is expected over the next four years of which \$161,000 is anticipated to be received in the next 12 months.

***Legal Proceedings***

From time to time, we are involved in litigation concerning consumer protection, employment, intellectual property and other commercial matters related to the conduct and operation of our business and the sale of products on our Website. In connection with such litigation, we may be subject to significant damages. In some instances other parties may have contractual indemnification obligations to

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us. However, such contractual obligations may prove unenforceable or non-collectible, and in the event we cannot enforce or collect on indemnification obligations, we may bear the full responsibility for damages, fees and costs resulting from such litigation. We may also be subject to equitable remedies and penalties. Such litigation could be costly and time consuming and could divert or distract our management and key personnel from our business operations. Due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, results of operations, financial position, or cash flows.

On February 2, 2007, along with five shareholder plaintiffs, we filed a lawsuit in the Superior Court of California, County of San Francisco against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. In September 2007, we filed an amended complaint adding two plaintiff shareholders, naming Lehman Brothers Holdings Inc. as a defendant, eliminating the previous claim of intentional interference with prospective economic advantage and clarifying various points of other claims in the original complaint. The suit alleged that the defendants, who control over 80% of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as fails to deliver and that the defendants' actions caused and continue to cause dramatic distortions within the nature and amount of trading in our stock as well as dramatic declines in the share price of our stock. The suit asserts that a persistent large number of fails to deliver creates significant downward pressure on the price of a company's stock and that the amount of fails to deliver has exceeded our entire supply of outstanding shares. The suit accused the defendants of violations of California securities laws and common law, specifically, conversion, trespass to chattels, intentional interference with prospective economic advantage, and violations of California's Unfair Business Practices Act. In April 2007, defendants filed a demurrer and motion to strike our complaint. We opposed the demurrer and motion to strike. In July 2007 the court substantially denied defendants' demurrer and motion to strike. In November 2007, the defendants filed additional motions to strike. In February 2008, the court denied defendants' motion to strike our claims under California's Securities Anti-Fraud statute and defendants' motion to strike our common law punitive damages claims, but granted in part the defendants' motion to strike our claims under California's Unfair Business Practices Act, while allowing our claims for injunctive relief under California's Unfair Business Practices Act. Lehman Brothers Holdings filed for bankruptcy on September 15, 2008 and Barclays Bank purchased its investment banking and trading business. We elected not to pursue our claims against Lehman Brothers Holdings in the bankruptcy proceedings. Dislocations in the financial markets and economy could result in additional bankruptcies or consolidations that may impact the litigation or the ability to collect a judgment. On January 12, 2009, Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Execution & Clearing L.P., Citigroup, Inc., Citigroup Global markets, Inc., Credit Suisse (USA) Inc., and Credit Suisse Securities (USA) LLC filed a motion to strike portions of the Second Amended Complaint regarding certain allegations of conspiracy among defendants and the request for punitive damages. Also, on January 12, 2009, Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Execution & Clearing L.P., Citigroup, Inc., Citigroup Global markets, Inc., Credit Suisse (USA) Inc., and Credit Suisse Securities (USA) LLC filed a demurrer to the first and second causes of action for conversion and trespass to chattels and a motion to strike various other allegations of the Second Amended Complaint. On March 19, 2009, the Court sustained the demurrer to first and second causes of action but granted leave to amend the complaint. The motion to strike was denied. On April 20, 2009, we amended our complaint against all the defendants, re-pleading conversion and trespass to chattels causes of action. Defendants again filed demurrer to the amended complaint and, on July 23, 2009, the court sustained the demurrer. On December 15, 2010, we and the other plaintiffs in the case entered into a settlement agreement with certain of the defendants requiring the defendants to pay in the aggregate \$4.5 million to plaintiffs. The other terms of settlement are confidential. At that time, remaining defendants in the suit were Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Execution & Clearing L.P., (Goldman Defendants), Merrill Lynch, Pierce, Fenner & Smith, Inc., Merrill Lynch Professional Clearing Corporation (Merrill Lynch Defendants), and Bank of America Securities LLC. On December 15, 2010, we filed a motion to amend our complaint against the Goldman and Merrill Lynch Defendants to add a cause of action based on the New Jersey Racketeer Influenced and Corrupt Organization (RICO) Act. The court allowed the amendment, and defendants challenged the claim by demurrer. The court sustained the defendants' demurrer. We thereafter submitted a proposed fifth amended complaint, which the court declined to allow. We recently entered a settlement agreement with Bank of America Securities LLC, the terms of which are confidential, and have dismissed the action as to that defendant. A trial date has been set for March 5, 2012. We intend to continue to vigorously prosecute this action.

On November 17, 2010 we were sued in the Superior Court of California, County of Alameda, by District Attorneys for the California Counties of Alameda, Marin, Monterey, Napa, Santa Clara, Shasta and Sonoma County, and the County of Santa Cruz recently joined the suit. These district attorneys seek damages and an injunction under claims for violations of California consumer protection laws, alleging we made untrue or misleading statements concerning our pricing, price reductions, sources of products and shipping charges. The complaint asks for damages in the amount of not less than \$15 million. The nature of the loss contingencies relating to claims that have been asserted against us are described above. The suit is in the discovery stage. We intend to vigorously defend this action.

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On May 30, 2008 we filed a complaint in New York state court against the New York State Department of Taxation and Finance, its Commissioner, the State of New York and its governor, alleging that a New York state tax law is unconstitutional. The effect of the New York law is to require Internet sellers to collect and remit New York sales taxes on their New York sales even if the seller has no New York tax nexus other than with New York based independent contractors who are Internet advertising affiliates. The complaint asks for the court to declare the law unconstitutional and enjoin its application to us. New York filed a motion to dismiss. We responded

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to the motion and filed a motion for summary judgment, and both motions were heard simultaneously. On January 12, 2009, the court granted New York's motion to dismiss and denied our motion for summary judgment. We appealed the decision and on November 4, 2010 the New York Appellate Division upheld part of the lower court's ruling rejecting our claims that the law is unconstitutional on its face, but remanded our claims that the law is unconstitutional as applied, for further discovery and proceedings in the lower court. We filed with the New York State Court of Appeals a motion of leave to appeal the portions of the decision upholding the lower court's ruling. On March 15, 2011, the Appellate Division of the New York State Court of Appeals denied our motion for leave to appeal to the New York State Court of Appeals. We have determined not to pursue our claims that the law is unconstitutional as applied. We are proceeding with an appeal of the Appellate Division's ruling on our claim that the statute is unconstitutional on its face.

On August 12, 2008, we along with seven other defendants, were sued in the United States District Court for the Northern District of California, by Sean Lane, and seventeen other individuals, on their own behalf and for others similarly in a class action suit, alleging violations of the Electronic Communications Privacy Act, Computer Fraud and Abuse Act, Video Privacy Protection Act, and California's Consumer Legal Remedies Act and Computer Crime Law. The complaint relates to our use of a product known as Facebook Beacon, created and provided to us by Facebook, Inc. Facebook Beacon provided the means for Facebook users to share purchasing data among their Facebook friends. The parties extended by agreement the time for defendants' answer, including our answer, and thereafter, the Plaintiff and Facebook proposed a stipulated settlement to the court for approval, which would resolve the case without requirement of financial contribution from us. On March 17, 2010, over objections lodged by some parties, the court accepted the proposed settlement. Various parties objecting to the settlement have appealed and their appeal is now pending. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made.

On November 14, 2008, we filed suit in Ohio state court against the Ohio Tax Commissioner, the Ohio Attorney General and the Governor of Ohio, alleging the Ohio Commercial Activity Tax is unconstitutional. Enacted in 2005, Ohio's Commercial Activity Tax is based on activities in Ohio that contribute to production or gross income for a company whether or not the company has a physical presence in or nexus within the state. Our complaint asked for a judgment declaring the tax unconstitutional and for an injunction preventing any enforcement of the tax. The defendants moved to dismiss the case. On July 28, 2009, the trial court ruled that there was no justiciable controversy in the case, as we had not yet been assessed a tax, and it granted the defendants' motions to dismiss. In September 2009, we received a letter of determination from the Ohio Department of Taxation noting the Department's determination that we are required to register for remitting of the Commercial Activity Tax, and owe \$612,784 in taxes, interest, and penalties as of June 30, 2009. The Ohio Department of Taxation issued additional estimated assessments of estimated tax, interest and penalties totaling \$73,489 as of September 30, 2011. We have filed protests to challenge the Department's Assessments on constitutional grounds and the matter is currently pending before the Ohio Department of Taxation's Legal Division for administrative review and determination. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We believe the determinations to be unlawful and erroneous and are vigorously contesting the determination.

On March 10, 2009, we were sued in a class action filed in the United States District Court, Eastern District of New York. Cynthia Hines, the nominative plaintiff on behalf of herself and others similarly situated, seeks damages under claims for breach of contract, common law fraud and New York consumer fraud laws. The Plaintiff alleges we failed to properly disclose our returns policy to her and that we improperly imposed a restocking charge on her return of a vacuum cleaner. We filed a motion to dismiss based upon assertions that our agreement with our customers requires all such actions to be arbitrated in Salt Lake City, Utah. Alternatively, we asked that the case be transferred to the United States District Court for the District of Utah, so that arbitration may be compelled in that district. On September 8, 2009 the motion to dismiss or transfer was denied, the court stating that our browsewrap agreement was insufficient under New York law to establish an agreement with the customer to arbitrate disputes in Utah. On October 8, 2009, we filed a Notice of Appeal of the court's ruling. The appeal was denied. On December 31, 2010 Hines filed an amended complaint. The amended complaint eliminated common law fraud claims and breach of contract claims and added claims for breach of Utah's consumer protection statute and various other state consumer protection statutes. The amended complaint also asks for an injunction. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. The suit is in final discovery stages. We filed motions to dismiss and to decertify the class. The court has not ruled on these motions. We intend to vigorously defend this action.

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On September 23, 2009, SpeedTrack, Inc. sued us along with 27 other defendants in the United States District Court in the Northern District of California. We are alleged to have infringed a patent covering search and categorization software. We believe that certain third party vendors of products and services sold to us are contractually obligated to indemnify us in this action. On November 11, 2009, the parties stipulated to stay all proceedings in the case until resolution of a the United States Patent and Trademark Office had concluded and resolved a reexamination of the patent in question, and also until a previously filed infringement action against Wal-Mart Stores, Inc. and other retailers resulted either in judgment or dismissal. Subsequently, the parties agreed to extend the time for defendants' complaint answer until 21 days following a court order to lift the stay to which the parties stipulated. The United States Patent and Trademark Office resolved the reexamination of the patent in question in favor of SpeedTrack, Inc. The case remains stayed, pending the outcome of the infringement action against Wal-Mart Stores, Inc. and other retailers. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

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On or about September 25, 2009, Alcatel-Lucent USA, Inc. filed suit against us and 12 other defendants in the United States District Court in the Eastern District of Texas. We are alleged to have infringed three patents purportedly related to a communications protocol between a user and server terminals, text input functionalities and search processes. We believe a third party vendor of search products and services sold to us is contractually obligated to indemnify us in this action as it pertains to the search patent. On October 14, 2011, a jury returned a verdict in our favor, finding non-infringement on all asserted claims, on all patents, and finding of invalidity of the Alcatel-Lucent patent, having to do with a communications protocol. Alcatel-Lucent may decide to challenge the jury's verdict by appeal or otherwise.

On May 11, 2010, Site Update Solutions, LLC filed suit against us and 34 other defendants in the United States District Court in the Eastern District of Texas (now transferred to the Northern District of California) for infringement of a patent claiming a process for maintaining ongoing registration for pages on a given search engine . . . a method to actively cause an updating of a specific Internet search engine database regarding a particular WWW resource. We, along with other defendants, filed a motion to transfer venue. The court granted the motion, and the case is now transferred to the Northern District of California. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors, if any.

On July 2, 2010, AdjustaCam LLC filed suit against us and 59 other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent covering hinged apparatuses for supporting cameras. The case has been settled for an immaterial amount, on terms that are confidential and the case is now dismissed.

On August 4, 2010, EON Corp. IP Holdings, LLC filed suit against us and 16 other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent covering a system and method for communicating between local subscriber units and a local base station repeater cell in a two-way communication interactive video network. The complaint alleges that we participate in joint infringement, contribute to infringement or induce others to infringe the patent because we sell mobile devices which devices are enabled with infringing components or which perform processes which infringe the patent. We believe that certain third party vendors of such devices sold to us are contractually obligated to indemnify us in this action. We have answered the complaint. The case is in its discovery stage. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On September 29, 2010, a trustee in bankruptcy filed against us an adversary proceeding in the matter of In re: Petters Company, Inc., a case filed in United States Bankruptcy Court, in the District of Minnesota. The complaint alleges principal causes of action against us under various Bankruptcy Code sections and the Minnesota Fraudulent Transfer Act, to recover damages for alleged transfers of property from the Petters Company occurring prior to the filing of the case initially as a civil receivership in October 2008. The trustee's complaint alleges such transfers occurred in at least one note transaction whereby we transferred at least \$2,300,000 and received in return transfers totaling at least \$2,547,406. The trustee does not specify a date for the transactions; however we believe that any alleged transaction with the Petters Company would have taken place in excess of seven years from the date of the filing of the adversary proceeding. The case is in its early stages. We filed a motion to dismiss on statute of limitations and other grounds. The court has not ruled upon the motion to dismiss. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action.

On April 4, 2011, Walker Digital, LLC filed suit against us and 24 other defendants in the United States District Court for the District of Delaware infringement of a patent covering a system of providing to purchasers a substitution recommendation for goods offered for purchase on a website. We believe that certain third party vendors are contractually obligated to indemnify us in this action. We answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights

with our vendors.

On September 11, 2011, Droplets, Inc. filed suit against us and eight other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent covering strings of programming code downloaded from a server to a client computer. We are in the process of answering the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On September 13, 2011, Select Retrieval LLC filed suit against us and 79 other defendants in the United States District Court for the District of Delaware for infringement of a patent covering the hierarchical display of interactive links on a webpage. We have not been served with the complaint, but intend to vigorously defend the case if served.

On September 15, 2009, we received a notice from the Securities and Exchange Commission ( SEC ) stating that the SEC is conducting an investigation concerning our previously-announced financial restatements of 2006 and 2008 and other matters. The subpoena accompanying the notice covers documents related to the restatements and also to our billings to our partners in the fourth



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quarter of 2008 and related collections, and our accounting for and implementation of software relating to our accounting for customer refunds and credits, including offsets to partners, and related matters. We have cooperated and intend to continue to cooperate fully with the investigation.

We establish liabilities when a particular contingency is probable and estimable. As of September 30, 2011, we have accrued \$1.3 million in light of these probable and estimable liabilities. It is reasonably possible that the actual losses may exceed our accrued liabilities.

We have other contingencies which are reasonably possible; however, the reasonably possible exposure to losses cannot currently be estimated.

**6. INDEMNIFICATIONS AND GUARANTEES**

During our normal course of business, we have made certain indemnities, commitments, and guarantees under which we may be required to make payments in relation to certain transactions. These indemnities include, but are not limited to, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to our directors and officers to the maximum extent permitted under the laws of the State of Delaware. The duration of these indemnities, commitments, and guarantees varies, and in certain cases, is indefinite. In addition, the majority of these indemnities, commitments, and guarantees do not provide for any limitation of the maximum potential future payments we could be obligated to make. As such, we are unable to estimate with any reasonableness our potential exposure under these items. We have not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. We do, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable.

**7. STOCK AND DEBT REPURCHASE PROGRAM**

We retired all of the Senior Notes that remained outstanding on September 21, 2011 for \$24.5 million in cash, resulting in a loss of \$26,000 on early extinguishment of debt, net of \$26,000 of associated unamortized discount. We retired \$34.6 million of the Senior Notes during the nine months ended September 30, 2011, for \$34.6 million in cash, resulting in a loss of \$54,000 on early extinguishment of debt, net of \$77,000 of associated unamortized discount. Of the \$34.6 million in Senior Notes retired during the nine months ended September 30, 2011, \$10.1 million were held by Chou or an affiliate of Chou and \$21.7 million were held by Fairfax or an affiliate of Fairfax. Chou and Fairfax are beneficial owners of more than 5% of our common stock. We retired \$16.1 million of the Senior Notes during the three months ended September 30, 2010 for \$15.8 million in cash, resulting in a gain of \$141,000 on early extinguishment of debt, net of \$92,000 of associated unamortized discount. We retired \$25.4 million of the Senior Notes during the nine months ended September 30, 2010 for \$24.9 million in cash, resulting in a gain of \$346,000 on early extinguishment of debt, net of \$158,000 of associated unamortized discount.

As of September 30, 2011 and December 31, 2010, zero and \$34.5 million of the Senior Notes, net of debt discount remained outstanding, respectively.

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During the three months ended September 30, 2011 and 2010, we withheld from vesting restricted stock awards a total of 180 and 150 shares of our common stock for \$2,000 and \$3,000 respectively. For the nine months ended September 30, 2011 and 2010, we withheld from vesting restricted stock awards a total of 98,000 and 63,000 shares of our common stock for \$1.6 million and \$821,000 respectively. The shares withheld represented the minimum tax withholdings upon the vesting of those restricted stock award grants to satisfy the minimum tax withholdings owed by the grantee of the restricted stock award grant. None of these shares were repurchased in the open market.

### **8. STOCK-BASED AWARDS**

We have equity incentive plans that provide for the grant to employees of stock-based awards, including stock options and restricted stock.

Stock-based compensation expense was as follows (in thousands):

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	Three months ended September 30,				Nine months ended September 30,			
	2011		2010		2011		2010	
Stock options	\$	13	\$	364	\$	194	\$	1,237
Restricted stock awards		688		922		2,217		2,533
Total stock-based compensation expense	\$	701	\$	1,286	\$	2,411	\$	3,770

*Restricted stock awards*

During the three and nine months ended September 30, 2011, the Compensation Committee of the Board of Directors approved grants of zero and 265,000 restricted stock awards to our officers, board members and employees, respectively. The restricted stock awards vest over three years at 25% at the end of the first year, 25% at the end of the second year and 50% at the end of the third year and are subject to the employee's continuing service to us. At September 30, 2011, there were 578,000 unvested restricted stock awards that remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is recognized on a straight line basis over the three-year vesting schedule. The weighted average grant date fair value of restricted stock awards granted during the three and nine months ended September 30, 2011 was zero and \$15.53, respectively.

The following table summarizes restricted stock award activity during the nine months ended September 30, 2011 (in thousands):

	Nine months ended September, 30 2011	
	Units	Weighted Average Grant Date Fair Value
Outstanding beginning of year	685	\$ 12.08
Granted at fair value	265	15.53
Vested	(314)	12.16
Forfeited	(58)	14.31
Outstanding end of period	578	\$ 13.43

**9. REDEEMABLE COMMON STOCK**

In June 2009, we discovered that we had inadvertently issued 203,737 more shares of our common stock in connection with our 401(k) plan than had been registered with the Securities and Exchange Commission for offer in connection with the 401(k) plan. These shares were contributed to or otherwise acquired by participants in the 401(k) plan between August 16, 2006, and June 17, 2009. As a result, certain participants in the 401(k) plan may have had rescission rights relating to the unregistered shares, although we believe that the federal statute of limitations applicable to any such rescission rights would be one year, and that the statute of limitations had already expired at June 30, 2009 with respect to most of the inadvertent issuances.

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On August 31, 2009, we entered into a Tolling and Standstill Agreement (the Tolling Agreement ) with the Overstock.com, Inc. Employee Benefits Committee (the Committee ) relating to the 401(k) plan. We entered into the Tolling Agreement in order to preserve certain rights, if any, of plan participants who acquired shares of Overstock common stock in the plan between July 1, 2008 and June 30, 2009 (the Purchase Period ). In August 2010, we made a registered rescission offer to affected participants in the plan who acquired shares of Overstock common stock during the Purchase Period. The rescission offer applied to shares purchased during the Purchase Period at prices ranging from \$6.77 per share to \$21.17 per share. On October 6, 2010, our rescission offer expired. As a result of the offer, we repurchased 1,202 shares of common stock for \$26,000. On October 14, 2010 we terminated the Tolling Agreement.

During the nine months ended September 30, 2011, we reclassified 46,000 shares or \$582,000 of common stock from temporary to permanent equity due to the expiration of potential rescission rights. At September 30, 2011, none of our shares were classified outside stockholder s equity due to the expiration of potential rescission rights associated with those common shares. At December 31, 2010, approximately 46,000 shares or \$570,000 of our common stock including interest were classified outside stockholders equity.

### 10. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 *Segment Reporting*. Segments were determined based on products and services provided by each segment. There were no inter-segment sales or transfers during the three months ended September 30, 2011 and 2010. We evaluate the performance of our segments and allocate resources to them based primarily on gross

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profit. The table below summarizes information about reportable segments for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three months ended September 30, Fulfillment partner			Nine months ended September 30, Fulfillment partner		
	Direct		Total	Direct		Total
<b>2011</b>						
Revenue, net	\$ 34,749	\$ 204,989	\$ 239,738	\$ 116,353	\$ 623,847	\$ 740,200
Cost of goods sold	32,472	168,893	201,365	105,733	506,240	611,973
Gross profit	\$ 2,277	\$ 36,096	\$ 38,373	\$ 10,620	\$ 117,607	\$ 128,227
Operating expenses			46,314			143,573
Other income (expense), net			(86)			(885)
Benefit for income taxes			(240)			(202)
Net loss			\$ (7,787)			\$ (16,029)
<b>2010</b>						
Revenue, net	\$ 47,508	\$ 197,912	\$ 245,420	\$ 140,458	\$ 600,545	\$ 741,003
Cost of goods sold	43,174	160,868	204,042	124,192	486,583	610,775
Gross profit	\$ 4,334	\$ 37,044	\$ 41,378	\$ 16,266	\$ 113,962	\$ 130,228
Operating expenses			44,554			130,411
Other income (expense), net			(226)			(709)
Provision (benefit) for income taxes			(44)			78
Net loss			\$ (3,358)			\$ (970)

The direct segment includes revenues, direct costs, and cost allocations associated with sales fulfilled from our leased warehouses. Costs for this segment include product costs 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 our third-party fulfillment partner sales and are earned from selling the merchandise of third parties over our Website. Costs for this segment include product costs, outbound freight and fulfillment costs, credit card fees and customer service costs.

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

For the three and nine months ended September 30, 2011 and 2010, over 99% of sales were made to customers in the United States of America. At September 30, 2011 and December 31, 2010, all of our fixed assets were located in the United States of America.

**11. EMPLOYEE RETIREMENT PLAN**

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In December 2009, we implemented a Non Qualified Deferred Compensation plan for senior management. The plan allows eligible members of senior management to defer their receipt of compensation from us, subject to the restrictions contained in the plan. Participants are 100% vested in their deferred compensation amounts and the associated gains or losses. For Company contributions, if any, and the associated gains or losses, the participants shall vest in those deferred compensation amounts according to a vesting schedule that we shall determine at the time the Company contribution is made. As of September 30, 2011, no Company contributions have been made into the NQDC Plan. Participants are generally eligible to receive distributions from the plan two plan years subsequent to the plan year their initial deferral contribution is made. Deferred compensation amounts are held in a rabbi trust, which invests primarily in mutual funds. The trust assets, which consist primarily of mutual funds, are recorded in our consolidated balance sheets because they are subject to the claims of our creditors. The corresponding deferred compensation liability represents the amounts deferred by the plan participants plus or minus any earnings or losses on the trust assets. The trust assets totaled \$246,000, while the NQDC Plan's liabilities totaled \$249,000 at September 30, 2011. The assets and liabilities of the NQDC Plan were included in Other current and long-term assets, Accrued liabilities and Other long-term liabilities in the consolidated balance sheets. The gains and losses on the NQDC Plan's assets were immaterial for the three and nine months ended September 30, 2011 and 2010.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Special Note Regarding Forward-Looking Statements**

*This Quarterly Report on Form 10-Q and the documents incorporated herein by reference contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are therefore entitled to the protection of the safe harbor provisions of these laws. These forward-looking statements involve risks and uncertainties, and relate to future events or our future financial or operating performance. The forward-looking statements include all statements other than statements of historical fact, including, without limitation, all statements regarding:*

- *the anticipated benefits and risks of our business and plans;*
- *our ability to attract and retain customers in a cost-efficient manner;*
- *the effectiveness of our marketing;*
- *our future operating and financial results;*
- *the competition we face and will face in our business;*
- *the effects of government regulation;*
- *our future capital requirements and our ability to satisfy our capital needs;*
- *our expectations regarding the adequacy of our liquidity;*
- *our ability to retire or refinance our finance obligations and debt;*
- *our expansion in international markets;*
- *our plans for changes to our business;*
- *our beliefs regarding current or future litigation or regulatory actions;*
- *our expectations regarding existing and future tax laws and related laws and the application of those laws to our business;*
- *our expectations regarding the adequacy of our insurance coverage;*
- *the adequacy of our infrastructure, including our backup facilities and our disaster planning;*
- *our belief that we can meet our published product shipping standards even during periods of relatively high sales activity;*
- *our belief that we can maintain or improve upon customer service levels that we and our customers consider acceptable;*
- *our expectations regarding the adequacy of our order processing systems and our fulfillment and distribution capabilities;*

- *our beliefs regarding the adequacy of our customer service capabilities;*
- *our expectations regarding the adequacy of our office and warehouse facilities;*
- *our expectations regarding our vacation shopping service, our insurance shopping service, our international sales efforts, our car listing service and our community site, and the anticipated functionality and results of operations of any of them;*
- *our belief that we and our fulfillment partners will be able to maintain inventory levels at appropriate levels despite the seasonal nature of our business; and*
- *our belief that we can successfully offer and sell a constantly changing mix of products and services.*

*Furthermore, in some cases, you can identify forward-looking statements by terminology such as may, will, could, should, expect, plan, intend, anticipate, believe, estimate, predict, potential or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider the risks outlined in our Annual Report on Form 10-K for the year ended December 31, 2010, including those described in Item 1A under the caption Risk Factors. These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement. Except as otherwise required by law, we expressly disclaim any obligation to release publicly any update or revisions to any forward-looking statements to reflect any changes in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.*

*These forward-looking statements speak only as of the date of this report and, except as required by law, we undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report.*

## **Overview**

We are an online retailer offering discount brand name, non-brand name and closeout merchandise, including bed-and-bath goods, home décor, kitchenware, furniture, watches and jewelry, apparel, electronics and computers, sporting goods, and designer accessories, among other products. We also sell hundreds of thousands of best seller and current run books, magazines, CDs, DVDs and video games ( BMMG ). We sell these products through our Internet websites located at [www.overstock.com](http://www.overstock.com), [www.o.co](http://www.o.co) and [O.biz](http://O.biz) ( Website ). Although our three websites are located at different domain addresses, the technology and equipment and processes supporting the Website and the process of order fulfillment described herein are the same for all three websites.



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Our company, based in Salt Lake City, Utah, was founded in 1997. We launched our initial website in March 1999. Our Website offers our customers an opportunity to shop for bargains conveniently, while offering our suppliers an alternative inventory liquidation or sales channel. We continually add new, sometimes limited, inventory products to our Website in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We sell products primarily in the United States, with a small amount of products (less than 1% of sales) sold internationally.

As used herein, Overstock, Overstock.com, O.co, we, our and similar terms include Overstock.com, Inc. and its subsidiaries, unless the context indicates otherwise.

**Our Business**

We deal primarily in discount, replenishable, and closeout merchandise and we use the Internet to aggregate both supply and demand to create an efficient marketplace for selling these products. We provide manufacturers with a one-stop liquidation channel to sell both large and small quantities of excess, closeout and replenishable inventory without disrupting sales through traditional channels, which can result in weaker pricing and decreased brand strength. The merchandise offered on our Website is from a variety of sources including well-known, brand-name manufacturers. We have organized our shopping business (sales of product offered through the Shopping Section of our Website) into two principal segments a direct business and a fulfillment partner business. We currently offer approximately 245,000 non-BMMG products in 19 major departments, and approximately 706,000 BMMG products. Consumers and businesses are able to access and purchase our products 24 hours a day from the convenience of a computer, Internet-enabled mobile telephone or other Internet-enabled devices. Our team of customer service representatives assists customers by telephone, instant online chat and e-mail. Nearly all of our sales are to customers located in the United States. Less than 1% of our sales are made to international customers. During the nine months ended September 30, 2011 and 2010 no single customer accounted for more than 1% of our total revenue.

*Direct business*

Our direct business includes sales made to individual consumers and businesses, which are fulfilled from our leased warehouses in Salt Lake City, Utah.

*Fulfillment partner business*

For our fulfillment partner business, we sell merchandise of other retailers, cataloguers or manufacturers ( fulfillment partners ) through our Website. We are considered to be the primary obligor for the majority of these sales transactions and we record revenue from the majority of these sales transactions on a gross basis. Our use of the term partner or fulfillment partner does not mean that we have formed any legal partnerships with any of our fulfillment partners. We currently have relationships with approximately 1,900 third parties who supply approximately 236,000 non-BMMG products, as well as most of the BMMG products, on our Website. These third-party fulfillment partners perform essentially the same fulfillment operations as our warehouses, such as order picking and shipping; however, we handle returns and customer service related to substantially all orders placed through our Website. Revenue generated from sales on our Shopping site from both the direct and fulfillment partner businesses is recorded net of returns, coupons and other discounts.

Both direct and fulfillment partner revenues are seasonal, with revenues historically being the highest in the fourth quarter, which ends December 31, reflecting higher consumer holiday spending. We anticipate this will continue in the foreseeable future.

Generally, we require verification of receipt of payment, or authorization from credit card or other payment vendors whose services we offer to our customers (such as PayPal and BillMeLater), before we ship products to consumers or business purchasers. From time to time we grant credit to our business purchasers with normal credit terms (typically 30 days). For sales in our fulfillment partner business, we generally receive payments from our customers before our payments to our suppliers are due.

#### *International business*

We began selling products through our Website to customers outside the United States in late August 2008. As of September 30, 2011, we were offering products to customers in over 90 countries. We do not have sales operations outside the United States, and are using a U.S. based third party to provide logistics and fulfillment for all international orders. Revenue generated from our international business is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our warehouses or from a fulfillment partner.

#### *Consignment*

In September 2009, we began offering a consignment service to suppliers where the suppliers' merchandise is stored in and shipped from our leased warehouses. We pay the consignment supplier upon sale of the consigned merchandise to our customer.

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Revenue from our consignment service business is less than 1% of total net revenue and is included in the fulfillment partner segment.

*Other businesses*

We operate an online car listing service as part of our Website. The car listing service allows sellers to list vehicles for sale and allows buyers to review vehicle descriptions, post offers to purchase, and provides the means for purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. We also earn advertisement revenue derived from our cars business. Revenue from the cars businesses is included in the fulfillment partner segment on a net basis.

We operate an online site, O.biz, a website where customers and businesses can shop for bulk and business related items, while offering manufacturers, distributors and other retailers an alternative sales channel for liquidating their inventory. Revenue generated from our O.biz is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our warehouses or from a fulfillment partner.

In April 2011, we began operating a vacations shopping site as part of our website where customers can purchase discount vacation packages. We also earn advertisement revenue from our vacations business. Revenue from the vacations businesses is included in the fulfillment partner segment on a net basis.

In July 2011, we began operating an insurance shopping service as part of our website where customers can shop for auto and home insurance and compare quotes from various insurance providers. We also earn advertisement revenue from our insurance business. Revenue generated from our insurance shopping site is included in fulfillment partner segment on a net basis.

We operated an online auction service as part of our Website. In July 2011, we removed our Marketplace tab for auctions from our Website and no longer provide auction services. The financial results and related assets of the online auction service were not significant to our business. Our Marketplace tab allowed sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. We recorded only our listing fees and commissions for items sold as revenue. From time to time, we also sold items returned from our shopping business through our auction service, and for these sales, we recorded the revenue on a gross basis. Revenue from the auctions is included in the fulfillment partner segment.

We operated an online site for listing real estate for sale as part of our Website. On June 30, 2011, we removed our online site for listing real estate for sale from our Website and no longer provide these real estate listing services. The financial results and related assets of the online site for listing real estate for sale were not significant to our business. The real-estate listing service allowed customers to search active listings across the country. Listing categories included foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Revenue from the real estate business is included in the fulfillment partner segment on a net basis.

In August 2010, we introduced Eziba.com, a private sale website where members can shop exclusive deals on the latest home décor products, jewelry, apparel and accessories from many leading brands. On June 30, 2011, we turned off the Eziba.com website; however, we continue to

sell the type of products that were listed on Eziba.com through our websites, O.co and Overstock.com.

*Rebranding and the use of O.co*

In our efforts to extend our international reach, we have commenced a re-branding effort, starting with the use of a single letter domain, O.co. We believe that O.co is a domain designation more easily understood and used internationally. In April 2011, we acquired naming rights to the Oakland-Alameda County Coliseum, and in June 2011, we announced the name of the facility as the O.co Coliseum. We have begun the process of prominently featuring the O.co name in our public announcements and other branding and marketing efforts. We are monitoring customer and user use and acceptance of this single letter domain name.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The Securities and Exchange Commission ( SEC ) has defined a company s critical accounting policies as the ones that are most important to the portrayal of the company s financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified the critical accounting policies, estimates and judgments addressed below. We also have other key accounting policies, which involve the use of estimates, judgments, and assumptions that are significant to understanding our results. For additional information, see Item 1 of Part I, Financial Statements Note 2 Accounting Policies. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates. Our critical accounting policies are as follows:

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- revenue recognition;
- estimating valuation allowances and accrued liabilities (specifically, the allowances for returns, credit card chargebacks, doubtful accounts and obsolete and damaged inventory);
- internal use software and website development (acquired and developed internally);
- accounting for income taxes;
- valuation of long-lived and intangible assets and goodwill; and
- loss contingencies.

*Revenue recognition*

We derive our revenue primarily from two sources: direct revenue and fulfillment partner revenue, including listing fees and commissions collected from products being listed and sold through the Auctions tab, which we removed from our site in July 2011, advertisement revenue derived from our real estate listing business, which we removed from our site on June 30, 2011, from our cars listing business, and from advertising on our shopping, vacations and insurance pages. We have organized our operations into two principal segments based on the primary source of revenue: direct revenue and fulfillment partner revenue.

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and, therefore, recognized as revenue at the end of the period. Our delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the type of shipping carrier (as carriers have different in-transit times); (ii) the fulfillment source (either our warehouses or those of our fulfillment partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment.

We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

The following table shows the effect that hypothetical changes in the estimate of average shipping transit times would have had on the reported amount of revenue and net loss for the three months ended September 30, 2011 (in thousands):

Change in the Estimate of Average	<b>Three months ended September 30, 2011</b>	
	Increase (Decrease)	(Increase) Decrease Net

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<b>Transit Times (Days)</b>	<b>Revenue</b>	<b>Loss</b>
2	\$ (8,883)	\$ (1,376)
1	\$ (3,830)	\$ (586)
As reported	As reported	As reported