OVERSTOCK.COM, INC
Form 10-Q/A
March 17, 2008

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q/A

**Amendment No. 1**

**(Mark One)**

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

**For the quarterly period ended March 31, 2007**

**Or**

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

For the transition period from to

**Commission file number: 000-49799**

# OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

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

**6350 South 3000 East**

**Salt Lake City, Utah 84121**

(Address, including zip code, of

Registrant s principal executive offices)

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

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

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

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

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

There were 23,683,531 shares of the Registrant s common stock, par value $0.0001, outstanding on May 8, 2007.

**EXPLANATORY NOTE**

Overstock.com, Inc. (also referred to as the Company, we, or our ) is filing this Amendment No. 1 (the Amendment No. 1 ) to our Form 10-Q fo the quarterly period ended March 31, 2007 (the Form 10-Q ), originally filed with the Securities and Exchange Commission on May 9, 2007, for the purpose of providing currently dated 302 and 906 certifications, as the dates on the 906 certifications were omitted from the original filing.

The information set forth in our financial statements and the footnotes thereto in this Amendment No. 1 has not been modified or updated in any way from the information in our financial statements and the related footnotes included in the Form 10-Q. This Amendment No. 1 speaks as of the original filing date of the Form 10-Q and reflects only the changes to the 302 and 906 certifications mentioned above. No other information included in this Form 10-Q/A, including the information set forth in Part II, has been modified or updated in any way.

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**PART 1. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**Overstock.com, Inc.**

**Consolidated Balance Sheets (unaudited)**

**(in thousands)**

| | December 31, 2006 | March 31, 2007 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 126,965 | $ 68,080 |
| Accounts receivable, net | 11,638 | 7,811 |
| Note receivable | 6,702 | 2,761 |
| Inventories, net | 20,274 | 16,662 |
| Prepaid inventory | 2,241 | 2,601 |
| Prepaid expense | 7,473 | 9,435 |
| Current assets of held for sale subsidiary | 4,718 | 2,148 |
| Total current assets | 180,011 | 109,498 |
| Property and equipment, net | 56,198 | 48,909 |
| Goodwill | 2,784 | 2,784 |
| Other long-term assets, net | 578 | 483 |
| Long-term assets of held for sale subsidiary | 16,594 | 12,805 |
| Total assets | $ 256,165 | $ 174,479 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 66,039 | $ 27,936 |
| Accrued liabilities | 40,142 | 22,976 |
| Capital lease obligations, current | 5,074 | 3,810 |
| Current liabilities of held for sale subsidiary | 3,684 | 993 |
| Total current liabilities | 114,939 | 55,715 |
| Capital lease obligations, non-current | 3,983 | |
| Convertible senior notes | 75,279 | 75,365 |
| Total liabilities | 194,201 | 131,080 |
| Commitments and contingencies (Notes 12 and 13) | | |
| Stockholders equity: | | |
| Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2006 and March 31, 2007 | | |
| Common stock, $0.0001 par value, 100,000 shares authorized, 25,069 and 25,258 shares issued as of December 31, 2006 and March 31, 2007, respectively | 2 | 2 |
| Additional paid-in capital | 325,771 | 327,399 |
| Accumulated deficit | (198,694) | (220,077) |
| Treasury stock, 1,654 and 1,620 shares at cost as of December 31, 2006 and March 31, 2007, respectively | (64,983) | (63,778) |
| Accumulated other comprehensive loss | (132) | (147) |
| Total stockholders equity | 61,964 | 43,399 |
| Total liabilities and stockholders equity | $ 256,165 | $ 174,479 |

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

**Overstock.com, Inc.**

**Consolidated Statements of Operations (unaudited)**

**(in thousands, except per share data)**

| | Three months ended March 31, 2006 | 2007 |
|---|---|---|
| Revenue | | |
| Direct | $ 79,710 | $ 45,701 |
| Fulfillment partner | 98,334 | 112,229 |
| Total revenue | 178,044 | 157,930 |
| Cost of goods sold: | | |
| Direct(1) | 70,703 | 39,320 |
| Fulfillment partner | 83,587 | 93,295 |
| Total cost of goods sold | 154,290 | 132,615 |
| Gross profit | 23,754 | 25,315 |
| Operating expenses: | | |
| Sales and marketing(1) | 12,659 | 11,284 |
| Technology(1) | 13,424 | 14,973 |
| General and administrative(1) | 11,850 | 10,689 |
| Restructuring | | 6,089 |
| Total operating expenses | 37,933 | 43,035 |
| Operating loss | (14,179) | (17,720) |
| Interest income | 315 | 990 |
| Interest expense | (1,267) | (1,029) |
| Loss from continuing operations | (15,131) | (17,759) |
| Loss from discontinued operations | (779) | (3,624) |
| Net loss | (15,910) | (21,383) |
| Deemed dividend related to redeemable common shares | (33) | |
| Net loss attributable to common shares | $ (15,943) | $ (21,383) |
| Net loss per common share basic and diluted: | | |
| Loss from continuing operations | $ (0.78) | $ (0.75) |
| Loss from discontinued operations | $ (0.04) | $ (0.16) |
| Net loss per common share basic and diluted | $ (0.82) | $ (0.91) |
| Weighted average common shares outstanding basic and diluted | 19,385 | 23,594 |

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

| | | |
|---|---|---|
| Cost of goods sold direct | $ 96 | $ 107 |
| Sales and marketing | $ 70 | $ 78 |
| Technology | $ 159 | $ 177 |

| | | |
|---|---|---|
| General and administrative | $ 633 | $ 711 |

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

**Overstock.com, Inc.**

**Consolidated Statements of Stockholders Equity**

**and Comprehensive Loss (unaudited)**

**(in thousands)**

| | Common stock Shares | Common stock Amount | Additional Paid-in capital | Accumulated Deficit | Treasury stock Shares | Treasury stock Amount | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2006 | 25,069 | $ 2 | $ 325,771 | $ (198,694) | (1,654) | $ (64,983) | $ (132) | $ 61,964 |
| Exercise of stock options | 189 | | 1,153 | | | | | 1,153 |
| Treasury stock issued to employees as compensation | | | (603) | | 38 | 1,205 | | 602 |
| Stock-based compensation from employee options | | | 1,073 | | | | | 1,073 |
| Stock-based compensation to consultants in exchange for services | | | 5 | | | | | 5 |
| Comprehensive loss: | | | | | | | | |
| Net loss | | | | (21,383) | | | | (21,383) |
| Cumulative translation adjustment | | | | | | | (15) | (15) |
| Total comprehensive loss | | | | | | | | (21,398) |
| Balance at March 31, 2007 | 25,258 | $ 2 | $ 327,399 | $ (220,077) | (1,616) | $ (63,778) | $ (147) | $ 43,399 |

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

**Overstock.com, Inc.**

**Consolidated Statements of Cash Flows (unaudited)**

**(in thousands)**

| | Three months ended March 31, 2006 | Three months ended March 31, 2007 | Twelve months ended March 31, 2006 | Twelve months ended March 31, 2007 |
|---|---|---|---|---|
| **Cash flows from operating activities of continuing operations:** | | | | |
| Net loss | $ (15,910) | $ (21,383) | $ (36,518) | $ (107,239) |
| Adjustments to reconcile net loss to net cash used in operating activities of continuing operations: | | | | |
| Loss from discontinued operations | 779 | 3,624 | 3,350 | 9,727 |
| Depreciation and amortization | 6,150 | 7,771 | 18,626 | 33,948 |
| Realized (gain) loss from marketable securities | (217) | | 3,135 | (1,868) |
| Loss on disposition of property and equipment | 598 | | 2,055 | 1 |
| Stock-based compensation | 958 | 1,073 | 1,010 | 4,235 |
| Stock-based compensation to consultants for services | 43 | 5 | 54 | (15) |
| Treasury stock issued to employees as compensation | 507 | 602 | 699 | 882 |
| Amortization of debt discount and deferred financing fees | 139 | 86 | 452 | 364 |
| Restructuring | | 6,089 | | 11,763 |
| Gain from retirement of convertible senior notes | | | (6,158) | |
| Changes in operating assets and liabilities, net of effect of acquisition and discontinued operations: | | | | |
| Accounts receivable, net | 2,316 | 3,827 | (1,238) | (541) |
| Inventories, net | 11,918 | 3,612 | (31,223) | 58,703 |
| Prepaid inventory | 794 | (360) | 1,068 | 6,234 |
| Prepaid expenses | (1,894) | (1,962) | (614) | 936 |
| Other long-term assets, net | 47 | 90 | (1,490) | 539 |
| Accounts payable | (63,621) | (38,059) | (4,211) | (9,638) |
| Accrued liabilities | (15,185) | (23,255) | 7,537 | (19,986) |
| Net cash used in operating activities of continuing operations | (72,578) | (58,240) | (43,466) | (11,955) |
| **Cash flows from investing activities of continuing operations:** | | | | |
| Change in restricted cash | 198 | | 957 | 55 |
| Purchases of marketable securities | (100) | | (59,699) | |
| Sales of marketable securities | 7,281 | | 164,284 | 49,475 |
| Expenditures for property and equipment | (6,804) | (477) | (38,416) | (17,114) |
| Proceeds from sale of property and equipment | | | | 1 |
| Acquisition of Ski West | | | (25,111) | |
| Decrease in cash resulting from deconsolidation of variable interest entity | | | | (102) |
| Payments received on note receivable | | 3,941 | | 3,941 |
| Net cash provided by investing activities of continuing operations | 575 | 3,464 | 42,015 | 36,256 |
| **Cash flows from financing activities of continuing operations:** | | | | |
| Payments on capital lease obligations | (2,428) | (5,247) | (9,363) | (5,776) |
| Drawdown on line of credit | 30,728 | 1,169 | 42,596 | 57,122 |
| Payments on line of credit | (10,728) | (1,169) | (22,596) | (77,122) |
| Payments to retire convertible senior notes | | | (35,670) | |
| Proceeds from the issuance of common stock, net of issuance costs | | | | 64,406 |
| Purchase of treasury stock | | | (24,133) | |
| Settlement of call options for cash | | | 7,937 | |
| Exercise of stock options and warrants | 1,027 | 1,153 | 7,436 | 2,660 |
| Net cash provided by (used in) financing activities of continuing operations | 18,599 | (4,094) | (33,793) | 41,290 |
| Effect of exchange rate changes on cash | 15 | (15) | 119 | 4 |
| Cash (used in) provided by operating activities of discontinued operations | (176) | 410 | (221) | 2,167 |
| Cash used in investing activities of discontinued operations | (41) | (53) | (139) | (578) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net (decrease) increase in cash and cash equivalents | | (53,606) | | (58,528) | | (35,485) | | 67,184 |
| Change in cash and cash equivalents from discontinued operations | | 217 | | (357) | | 360 | | (1,590) |
| Cash and cash equivalents, beginning of period | | 55,875 | | 126,965 | | 37,611 | | 2,486 |
| Cash and cash equivalents, end of period | $ | 2,486 | $ | 68,080 | $ | 2,486 | $ | 68,080 |
| **Supplemental disclosures of cash flow information:** | | | | | | | | |
| Interest paid | $ | 278 | $ | 651 | $ | 4,800 | $ | 4,050 |
| Deemed dividend on redeemable common stock | $ | 33 | $ | | $ | 172 | $ | 66 |
| Lapse of rescission rights on redeemable common stock | $ | 554 | $ | | $ | 700 | $ | 2,750 |
| Equipment and software acquired under capital leases | $ | 2,273 | $ | | $ | 2,822 | $ | |
| Settlement of purchased call options for treasury stock | $ | | $ | | $ | 41,121 | $ | |
| Fair value of assets acquired | $ | | $ | | $ | 26,447 | $ | |
| Fair value of liabilities assumed | | | | | | (1,336) | | |
| Cash paid to purchase business | $ | | $ | | $ | 25,111 | $ | |

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

**Overstock.com, Inc.**

**Notes to Unaudited Consolidated Financial Statements**

## 1. BASIS OF PRESENTATION

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

## 2. ACCOUNTING POLICIES

*Principles of consolidation*

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

*Use of estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Internal-Use Software and Website Development*

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

During the first quarters of 2006 and 2007, the Company capitalized $8.1 million and $1.3 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $559,000 and $776,000 for those respective periods.

*Advertising expense*

The Company recognizes advertising expenses in accordance with SOP 93-7 *Reporting on Advertising Costs*. As such, the Company expenses the costs of producing advertisements at the time production occurs or the first time the advertising takes place, and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) during the period customers are acquired; or 2) based on the number of clicks generated during a given period over the term of the contract. Advertising expense included in sales and marketing expenses totaled $12.5 million and $10.6 million during the three months ended March 31, 2006 and 2007, respectively.

*Stock-based Compensation*

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

*Recent accounting pronouncements*

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

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return.

The Company adopted the provisions of FIN 48, on January 1, 2007. As a result of a full valuation allowance, the Company does not have any unrecognized tax benefits and there is no effect on its financial condition or results of operations as a result of implementing FIN 48. The Company is subject to audit by the IRS and various states for the prior 3 years. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months. The Company s policy is that it recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the quarter ended March 31, 2007.

The Company recognized no income tax benefit from the net loss generated in the three months ended March 31, 2006 and 2007. Statement of Financial Accounting Standards ( SFAS ) No. 109, Accounting for Income Taxes, requires that a valuation allowance be provided if it is more likely than not that some portion or all of a deferred tax asset will not be realized. The Company s ability to realize the benefit of its deferred tax asset will depend on the generation of future taxable income through profitable operations. As of March 31, 2007, the Company has established a full valuation allowance against it deferred tax assets.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements. The Company will adopt SFAS 157 on January 1, 2008. The Company anticipates that the adoption of SFAS 157 will not have a material impact on the Company s consolidated financial statements.

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

*Reclassifications*

Certain prior year amounts have been reclassified to conform to the current year presentation. In addition, the Company has revised its consolidated statements of cash flows for the year ended December 31, 2006 to present the operating and investing portion of the cash flows attributable to discontinued operations on a separately identifiable basis. The effect of these reclassifications had no impact on net income, total assets, total liabilities, or stockholders equity.

**3. RESTRUCTURING EXPENSE**

During the fourth quarter of 2006, the Company commenced implementation of a facilities consolidation and restructuring program designed to reduce the overall expense structure in an effort to improve future operating performance. The facilities consolidation and restructuring program should be substantially completed during calendar year 2007.

During the fiscal year 2006, the Company recorded $5.7 million of restructuring charges, of which $5.5 million, less the elimination of straight-line rent liability of $913,000, related to costs to terminate a co-location data-center lease. Other costs included in the restructuring charge related to $638,000 of accelerated amortization of leasehold improvements in the

Company s current office facilities that it is attempting to sublease and $450,000 of costs incurred to return these office facilities to their original condition as required by the Company s lease agreement.

In the first quarter of 2007, the Company accrued $4.6 million of restructuring charges related to the termination of a logistics services agreement and its vacated warehouse facilities in Indiana. The Company also recorded an additional $954,000 of restructuring charges related to accelerated amortization of leasehold improvements in the Company s current corporate office facilities that it is attempting to sublease, and $487,000 of other miscellaneous restructuring charges.

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

| | Balance 12/31/2006 | Charges to expense | Cash payment or accelerated amortization | Balance 3/31/2007 |
|---|---|---|---|---|
| Lease and contract termination costs | $ 5,499 | $ 4,648 | $ (5,499) | $ 4,648 |
| Asset retirement obligation | 450 | | (48) | 402 |
| Accelerated amortization of leasehold improvements | | 954 | (954) | |
| Other restructuring expenses | | 487 | (487) | |
| Total | $ 5,949 | $ 6,089 | $ (6,988) | $ 5,050 |

Lease and contract termination costs relate primarily to the termination of leases in conjunction with the consolidation of the IT data center and co-location facilities and Indiana logistics services and warehouses agreements. The accelerated amortization of leasehold improvements relates to our current office facilities that we are attempting to sublease within the year. Other restructuring expenses are costs related to the reduction of data center space and corporate headcount.

**4. DISCONTINUED OPERATIONS**

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

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

During the fourth quarter of 2006, in conjunction with the facilities consolidation and restructuring program described in Note 3, management decided to sell OTravel. The Company evaluated its plan to sell OTravel in accordance with SFAS 144, which requires that long-lived assets be classified as held for sale only when certain criteria are met. The Company has classified the OTravel assets and liabilities as held for sale as it has met these criteria as of December 31, 2006 and March 31, 2007, which include: management s commitment to a plan to sell the assets; the availability of the assets for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets has been initiated; the sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; the assets are being marketed at reasonable prices in relation to their fair value; and the unlikelihood that significant changes will be made to the plan to the sell the assets. The travel business is not part of the Company s core business operations or its strategic focus. The results of operations for the subsidiary were included in the fulfillment partner segment prior to being classified as discontinued operations.

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

The following table is a summary of the Company s discontinued operations for the three months ended March 31, 2006 and 2007 (in thousands):

| | Three months ended March 31, 2006 | | Three months ended March 31, 2007 | |
|---|---|---|---|---|
| Sales | $ | 2,162 | $ | 2,081 |
| Cost of sales | | (754) | | (572) |
| Gross profit | | 1,408 | | 1,509 |
| Sales and marketing | | (518) | | (342) |
| Technology | | (165) | | (44) |
| General and administrative | | (1,504) | | (905) |
| Goodwill impairment | | | | (3,842) |
| Loss from discontinued operations | $ | (779) | $ | (3,624) |

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

| | December 31, 2006 | | March 31, 2007 | |
|---|---|---|---|---|
| Assets of held for sale subsidiary: | | | | |
| Cash | $ | 1,365 | $ | 1,722 |
| Accounts receivable | | 3,267 | | 295 |
| Property and equipment, net | | 1,215 | | 1,268 |
| Goodwill and intangible assets, net | | 15,379 | | 11,537 |
| Other | | 86 | | 131 |
| Total assets of discontinued operations | $ | 21,312 | $ | 14,953 |
| Liabilities of held for sale subsidiary: | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ | 1,249 | $ | 434 |
| Accrued liabilities | | 912 | | 559 |
| Total liabilities of discontinued operations | $ | 2,161 | $ | 993 |

On April 25, 2007, the Company completed the sale of its wholly owned subsidiary OTravel.com, Inc. to Castles Travel, Inc., an affiliate of Kinderhook Industries, LLC, and Castles Media Company LLC, for $17.0 million. The proceeds include $11.0 million in cash and two $3.0 million promissory notes. The $3.0 million senior note matures three years from the close date and bears interest, payable quarterly, of 4.0%, 10.0% and 14.0% per year in the first, second and third year, respectively. The $3.0 million junior note matures five years from the close date and bears interest of 8.0% per year, compounding, and is payable at the termination of the note.

## 5. DERIVATIVE INSTRUMENTS

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

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

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

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

The Company had pledged its Foreign Notes as collateral for a $30.0 million revolving line of credit. Subsequent to the sale of the Foreign Notes, the borrowings under the Amended Credit Agreement (see Note 11) are now collateralized by cash balances held at Wells Fargo Bank, N.A.

**6. OTHER COMPREHENSIVE LOSS**

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

| | Three months ended March 31, 2006 | | Three months ended March 31, 2007 | |
|---|---|---|---|---|
| Net loss | $ | (15,910) | $ | (21,383) |
| Unrealized gain on Foreign Notes | | 485 | | |
| Foreign currency translation adjustment | | 15 | | (15) |
| Comprehensive loss | $ | (15,410) | $ | (21,398) |

**7. EARNINGS (LOSS) PER SHARE**

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

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

| | Three months ended March 31, 2006 | | Three months ended March 31, 2007 | |
|---|---|---|---|---|
| Loss from continuing operations | $ | (15,131) | $ | (17,759) |
| Deemed dividend related to redeemable common stock | | (33) | | |
| Loss from continuing operations attributable to common shares | | (15,164) | | (17,759) |
| Loss from discontinued operations | | (779) | | (3,624) |
| Net loss attributable to common shares | $ | (15,943) | $ | (21,383) |
| Weighted average common shares outstanding basic | | 19,385 | | 23,594 |
| Effective of dilutive securities: | | | | |
| Stock options | | | | |
| Convertible senior notes | | | | |
| Weighted average common shares outstanding diluted | | 19,385 | | 23,594 |
| Net loss per common share basic and diluted: | | | | |
| Loss from continuing operations | $ | (0.78) | $ | (0.75) |
| Loss from discontinued operations | $ | (0.04) | $ | (0.16) |
| Net loss per common share basic and diluted | $ | (0.82) | $ | (0.91) |

The stock options, warrants and convertible senior notes outstanding were not included in the computation of diluted earnings per share because to do so would have been antidilutive. The number of shares of stock options outstanding at March 31, 2006 and 2007 was 1,181,000 shares and 1,376,000 shares, respectively. As of March 31, 2007, the Company had $77.0 million of convertible senior notes outstanding, which could potentially convert into 1,010,000 shares of common stock in the aggregate.

**8. BUSINESS SEGMENTS**

Segment information has been prepared in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. Segments were determined based on products and services provided by each segment. There were no inter-segment sales or transfers during the three months ended March 31, 2006 or 2007. The Company evaluates the performance of its segments and allocates resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three months ended March 31, 2006 and 2007 (in thousands):

| | Three months ended March 31, | | |
|---|---|---|---|
| | Direct | Fulfillment partner | Consolidated |
| **2006** | | | |
| Revenue | $ 79,710 | $ 98,334 | $ 178,044 |
| Cost of goods sold | 70,703 | 83,587 | 154,290 |
| Gross profit | $ 9,007 | $ 14,747 | 23,754 |
| Operating expenses | | | (37,933) |
| Other income (expense), net | | | (952) |
| Loss from continuing operations | | | $ (15,131) |
| **2007** | | | |
| Revenue | $ 45,701 | $ 112,229 | $ 157,930 |
| Cost of goods sold | 39,320 | 93,295 | 132,615 |
| Gross profit | $ 6,381 | $ 18,934 | 25,315 |
| Operating expenses | | | (43,035) |
| Other income (expense), net | | | (39) |
| Loss from continuing operations | | | $ (17,759) |

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

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

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

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

### 9. PERFORMANCE SHARE PLAN

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

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

Approximately $400,000 and $250,000 of compensation expense under the plan has been included in general and administrative expenses for the quarters ended March 31, 2006 and 2007, respectively. As of March 31, 2007, the Company has accrued $1.2 million in total compensation expense under the plan.

**10. BORROWINGS**

*$30.0 million Amended Credit Agreement*

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

Borrowings and outstanding letters of credit under the Amended Credit Agreement are collateralized by cash balances held at Wells Fargo Bank, N.A.

At March 31, 2007, no amounts were outstanding under the Amended Credit Agreement, and Letters of Credit totaling $8.3 million were issued on behalf of the Company.

*$40.0 million WFRF Agreement*

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

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

Advances under the WFRF Agreement bear interest at either (a) the rate announced, from time to time, within Wells Fargo Bank, N.A. at its principal office in San Francisco as its prime rate or (b) a rate based on LIBOR plus a varying percentage between 1.25% and 1.75%; however, the annual interest rate on advances under the WFRF Agreement will be at least 3.50%. The WFRF Agreement includes affirmative covenants as well as negative covenants that prohibit a variety of actions without the lender s approval, including covenants that limit the Company s ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another person, (d) sell assets, (e) change its name or the name of any of its subsidiaries, (f) make certain changes to its business, (g) optionally prepay, acquire or refinance indebtedness, (h) consign inventory, (i) pay dividends on, or purchase, acquire or redeem shares of, its capital stock, (j) change its method of accounting, (k) make investments, (l) enter into transactions with affiliates, or (m) store any of its inventory or equipment with third parties. The Company was in compliance with these covenants as of March 31, 2007. At March 31, 2007, no amounts were outstanding under the WFRF Agreement. As of March 31, 2007, availability under the WFRF Agreement was $6.2 million.

*Capital leases*

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

Software and equipment relating to the capital leases totaled $17.7 million and $19.8 million at December 31, 2006 and March 31, 2007, respectively, with accumulated amortization of $12.4 million and $14.1 million at those respective dates.

Depreciation of assets recorded under capital leases was $1.5 million and $1.8 million for the three months ended March 31, 2006 and 2007, respectively. The Company expects that in the normal course of business, the leases will expire.

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

| **Twelve months ending March 31,** | | |
|---|---|---|
| 2008 | $ | 4,101 |
| Less: amount representing interest | | (291) |
| Present value of capital lease obligations | | 3,810 |
| Less: current portion | | (3,810) |
| Capital lease obligations, non-current | $ | |

**11. 3.75% CONVERTIBLE SENIOR NOTES**

In November 2004, the Company completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes ). Proceeds to the Company were $116.2 million, net of $3.8 million of initial purchaser s discount and debt issuance costs. The discount and debt issuance costs are being amortized using the straight-line method which approximates the interest method. During the three months ended March 31, 2006 and 2007, the Company recorded amortization of discount and debt issuance costs related to this offering totaling $86,000 for both periods. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

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

The indenture governing the Senior Notes requires the Company to comply with certain affirmative covenants, including making principal and interest payments when due, maintaining our corporate existence and properties, and paying taxes and other claims in a timely manner. The Company was in compliance with these covenants at March 31, 2007.

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

**12. COMMITMENTS AND CONTINGENCIES**

***Commitments***

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

In February 2005, the Company and Old Mill Corporate Center III, LLC (the Lessor ) entered into a Tenant Improvement Agreement (the OMIII Agreement ) relating to the office building. The OMIII Agreement sets forth the terms on which the Company paid the costs of certain improvements to the leased office space. The amount of the costs was approximately $2.0 million. The OMIII Agreement also required the

Company to provide a letter of credit in the amount of $500,000 to the Lessor to provide funds for the removal of certain improvements upon the termination of the lease.

During the fourth quarter 2006, the Company commenced implementation of a facilities consolidation and restructuring program (Note 3). The Company recorded a liability of $450,000 for the costs to dismantle and dispose of an escalator system and to return the leased facilities to their original condition under the Tenant Improvement Agreement and incurred additional amortization expense in connection with the revised useful life of certain leasehold improvements. In January 2007, the Company began marketing its leased office facilities for sub-lease.

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

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

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

In the first quarter of 2007, the Company terminated the Logistics Agreement and gave notice of intent to sublease the Indiana warehouse facilities under the License Agreement (see Note 3).

The Company leases 610,000 square feet for its warehouse facilities in Utah under operating leases which expire in August 2012.

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

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

| **Twelve months Ending March 31,** | | |
|---|---|---|
| 2008 | $ | 11,901 |
| 2009 | | 6,433 |
| 2010 | | 5,812 |
| 2011 | | 5,398 |
| 2012 | | 5,371 |
| Thereafter | | 14,885 |
| | $ | 49,800 |

Rental expense for operating leases totaled $1.3 million and $1.6 million for the three months ended March 31, 2006 and 2007, respectively.

***Redeemable Common Stock***

The estimated amount of redeemable common stock is based solely on the statutes of limitations of the various states in which stockholders may have rescission rights and may not reflect the actual results. The stock is not redeemable by its terms. The Company does not have any unconditional purchase obligations, other long-term obligations, guarantees, standby repurchase obligations or other commercial commitments. These rescission rights fully expired prior to the end of the third quarter of 2006, leaving no outstanding redeemable common stock as of September 30, 2006 forward.

***Legal Proceedings***

From time to time, the Company receives claims of and become subject to consumer protection, employment, intellectual property and other commercial litigation related to the conduct of our business. Such litigation could be costly and time consuming and could divert our management and key personnel from its business operations. The uncertainty of litigation increases these risks. In connection with such litigation, the Company may be subject to significant damages or equitable remedies relating to the operation of its business and the sale of products on our websites. Any such litigation may materially harm its business, prospects, results of operations, financial condition or cash flows. However, the Company does not currently believe that any of its outstanding litigation will have a material adverse effect on its financial statements.

In December 2003, the Company received a letter from Furnace Brook claiming that certain of the Company s business practices and its website infringe a single patent owned by Furnace Brook. After diligent efforts to show that the Company does not infringe the patent and Furnace Brook s continual demands that the Company enter into licensing arrangements with respect to the asserted patent, on August 12, 2005, the Company filed a complaint in the United States District Court of Utah, Central Division, seeking declaratory judgment that it does not infringe any valid claim of the Furnace Brook patent. Furnace Brook filed a motion to dismiss that complaint for lack of personal jurisdiction over Furnace Brook in Utah. On October 31, 2005, the United States District Court of Utah, Central Division, issued a decision to dismiss the Company s complaint for lack of personal jurisdiction over patent troll Furnace Brook. On December 14, 2005, the Company filed an appeal of the Utah decision with the United States Court of Appeals for the Federal Circuit. On August 18, 2006, the United States Court of Appeals for the Federal Circuit denied the Company s appeal. On August 18, 2005, shortly after the Company filed the complaint in Utah, Furnace Brook filed a complaint in the United States District Court for the Southern District of New York, alleging that certain of the Company s business practices and its website infringe a single patent owned by Furnace Brook. On September 9, 2005, the Company filed an answer denying the material allegations in Furnace Brook s claims. On

September 27, 2006, the United States District Court for the Southern District of New York issued a memorandum and order in a Markman Hearing which substantially adopted the Company s interpretation of the Furnace Brook patent. The Company filed motions for summary judgment relating to the litigation and on October 6, 2006, the United States District Court for the Southern District of New York heard oral argument on those motions and on October 30, 2006, the United States District Court for the Southern District of New York granted summary judgment in favor of the Company, ruling that the Company does not infringe the Furnace Brook patent as a matter of law. On November 9, 2006, Furnace Brook filed a notice of appeal to the United States Court of Appeals for the Federal Circuit. On January 16, 2007, the Company filed a brief with the Federal Circuit Court and the appeal is now pending. Oral argument on the appeal scheduled for May 10, 2007.

On August 11, 2005, along with a shareholder plaintiff, the Company filed a complaint against Gradient Analytics, Inc.; Rocker Partners, LP; Rocker Management, LLC; Rocker Offshore Management Company, Inc. and their respective principals in the Superior Court of California, County of Marin. On October 12, 2005, the Company filed an amended complaint against the same entities alleging libel, intentional interference with prospective economic advantage and violations of California s unfair business practices act. On March 7, 2006, the court denied the defendants demurrers to and motions to strike the amended complaint. The defendants each filed a motion to appeal the court s decision, the Company responded and the California Attorney General submitted an amicus brief supporting the Company s view; the court has ruled that this appeal stays discovery in the case. On April 10, 2007, the California Court of Appeals heard oral argument on the appeal; the California Court of Appeals has not yet issued its decision. The Company intends to pursue this action vigorously.

On May 9, 2006 the Company received a notice of an investigation and subpoena from the Securities and Exchange Commission, Salt Lake City District Office. On May 17, 2006, Patrick Byrne also received a subpoena from the Securities and Exchange Commission, Salt Lake City District Office. These subpoenas requested a broad range of documents, including, among other documents, all documents relating to the Company s accounting policies, the Company s targets, projections or estimates related to financial performance, the Company s recent restatement of its financial statements, the filing of its complaint against Gradient Analytics, Inc., the development and implementation of certain new technology systems and disclosures of progress and problems with those systems, communications with and regarding investment analysts, communications regarding shareholders who did not receive the Company s proxy statement in April 2006, communications with certain shareholders, and communications regarding short selling, naked short selling, purchases and sales of Company stock, obtaining paper certificates, and stock loan or borrow of Company shares. The Company and Mr. Byrne have responded to these subpoenas and each continues to cooperate with the Securities and Exchange Commission on this matter.

In November 2006, the Company received a letter from Applied Interactive, claiming that certain of the Company s business practices and its website infringe two patents owned by Applied Interactive and offering to enter into a licensing agreement. After determining that it does not infringe the patents and rejecting the offered licensing agreement, on February 2, 2007, the Company filed a complaint in the United States District Court, Southern District of New York, seeking declaratory judgment that it did not infringe any valid claim of the Applied Interactive patents. The Company and Applied Interactive have reached a confidential agreement in principal to settle this matter for an immaterial amount. The parties will dismiss the suit with prejudice once this agreement has been memorialized.

On February 2, 2007, along with five shareholder plaintiffs, the Company 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. The suit alleges 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 with in the nature and amount of trading in the Company s stock as well as dramatic declines in the share price of the Company s 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 the company s entire supply of outstanding shares. The suit accuses 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. The Company is seeking damages of $3.48 billion. The case is in its initial stages. The Company intends to vigorously prosecute this action.

On March 29, 2007, the Company, along with 63 other defendants, was sued in United States District Court for the Eastern District of Texas, Tyler Division, by Orion IP, LLC. The suit alleges that the Company and the other 63 defendants infringe two patents owned by Orion that relate to the making and using supply chain methods, sales methods, sales systems, marketing methods, marketing systems, and inventory systems. On April 30, 2007, the Company filed an answer denying Orion s allegations and a counterclaim asserting that Orion s patent is invalid. The case is in its initial stages. As it has consistently done with similar suits filed by patent trolls, the Company intends to vigorously defend this action.

**13. INDEMNIFICATIONS AND GUARANTEES**

During its normal course of business, the Company has made certain indemnities, commitments, and guarantees under which it 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 directors and officers of the Company 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 the Company could be obligated to make. As such, the Company is unable to estimate with any reasonableness its potential exposure under these items. The Company has not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. The Company does, 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. The Company carries specific and general liability insurance policies that the Company believes would, in most circumstances, provide some, if not total coverage for any claims arising from these indemnifications.

**14. STOCK OFFERINGS**

During 2006, the Company closed two offerings under an existing shelf registration statement, pursuant to which it sold 1.0 million shares of common stock in May and 2.7 million shares of common stock in December, with proceeds to the Company of approximately $25.0 million and $39.4 million, respectively, net of $594,000 of issuance costs. The Company has made no offerings in 2007.

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

*In addition to historical information, this Quarterly Report on Form 10-Q/A contains forward-looking statements. These statements relate to our, and in some cases our customers or other third parties , future plans, objectives, expectations, intentions and financial performance and the assumptions that underlie these statements. These forward-looking statements include, but are not limited to, statements regarding the following: our beliefs and expectations regarding the seasonality of our direct and fulfillment partner revenue; our beliefs regarding the sufficiency of our capital resources; planned distribution and order fulfillment capabilities; our beliefs, intentions and expectations regarding improvements of our order processing systems and capabilities; our intentions regarding the development of enhanced technologies and features; our intentions regarding the expansion of our customer service capabilities; our belief and intentions regarding improvements to our general and administrative functions; our beliefs and intentions regarding enhancements to our sales and marketing activities; our beliefs regarding the potential for growth in our customer base; our beliefs and intentions regarding our expansion into new markets, including international markets; our beliefs and intentions about entering into agreements to provide products and services to retail chains and other businesses; our belief regarding potential development of new Websites; our beliefs, intentions and expectations regarding promotion of new or complimentary product and sales formats; our belief, intentions and expectations regarding the expansion of our product and service offerings; our beliefs and intentions regarding expanding our market presence through relationships with third parties; our beliefs regarding the pursuit of complimentary businesses and technologies; our beliefs regarding the adequacy of our insurance coverage; our beliefs, intentions and expectations regarding litigation matters and legal proceedings, our defenses to such matters and our contesting of such matters; our beliefs and expectations regarding our existing cash and cash equivalents, cash requirements and sufficiency of capital; and our beliefs and expectations regarding interest rate risk, our investment activities and the effect of changes in interest rates.*

*These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially. For a detailed discussion of these risks and uncertainties please see Item 1A Risk Factors and the description of risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2006. 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.*

**Recent Developments**

During the fourth quarter of 2006, we commenced implementation of a facilities consolidation and restructuring program designed to reduce our overall expense structure in an effort to improve future operating performance. The facilities consolidation and restructuring program should be substantially completed during calendar year 2007.

As of December 31, 2006, we recorded $5.7 million of restructuring charges, of which $5.5 million, less the elimination of straight-line rent liability of $913,000, related to costs to terminate a co-location data-center lease. Other costs included in the restructuring charge related to $638,000 of accelerated amortization of leasehold improvements in our current office facilities that we are attempting to sublease and $450,000 of costs incurred to return these office facilities to their original condition as required by the lease agreement.

In the first quarter of 2007, we accrued $4.6 million of restructuring charges related to the termination of a logistics services agreement and our vacated warehouse facilities in Indiana. We also recorded an additional $954,000 of restructuring charges related to accelerated amortization of leasehold improvements in our current corporate office facilities that we are attempting to sublease, and $487,000 of other miscellaneous restructuring charges.

We have classified $15.0 million of assets and $993,000 of liabilities as held for sale related to our OTravel subsidiary. In conjunction with the discontinuance of OTravel, we performed an evaluation of the goodwill associated with the reporting unit pursuant to SFAS 142, and SFAS 144, *Accounting for the Impairment of Long-Lived Assets* and determined that goodwill of approximately $4.5 million was impaired as of December 31, 2006 based on a non-binding letter of intent to purchase this business. On April 25, 2007, the Company completed the sale of OTravel for $11.0 million of cash and $6.0 million of notes. Based on the estimated fair value of the discounted cash flows of the net proceeds from the sale, the Company recorded an additional goodwill impairment of $3.8 million as of March 31, 2007 (see Financial Statements Note 3 Discontinued Operations ).

Please see the Executive Commentary below as well as the rest of Management s Discussion and Analysis for discussion of other recent developments.

**Overview**

We are an online closeout retailer offering discount brand name merchandise, including bed-and-bath goods, home décor, kitchenware, watches, jewelry, electronics and computers, sporting goods, apparel, and designer accessories, among other products. We also sell books, magazines, CDs, DVDs, videocassettes and video games ( BMMG ). We also operate as part of our Website an online auction site a marketplace for the buying and selling of goods and services as well as an online site for listing cars for sale.

Our company, based in Salt Lake City, Utah, was founded in 1997, and we launched our first Website through which customers could purchase products in March 1999. Our Websites offer our customers an opportunity to shop for bargains conveniently, while offering our suppliers an alternative inventory liquidation distribution channel. We continually add new, limited inventory products to our Websites in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We offer approximately 36,000 products under multiple shopping tabs on our main website, plus almost 500,000 media products on our BMMG tab.

Closeout merchandise is typically available in inconsistent quantities and prices and often is only available to consumers after it has been purchased and resold by disparate liquidation wholesalers. We believe that the traditional liquidation market is therefore characterized by fragmented supply and fragmented demand. We utilize the Internet to aggregate both supply and demand and create a more efficient market for liquidation merchandise. Our objective is to provide a one-stop destination for discount shopping for products and services proven to be successfully sold through the Internet.

**Our Business**

Overstock utilizes the Internet to create a more efficient market for liquidation merchandise. We provide consumers and businesses with quick and convenient access to high-quality, brand-name merchandise at discount prices. Our shopping business includes both a direct business and a fulfillment partner business. During the quarter ended March 31, 2007, no single customer accounted for more than 1% of our total revenue. Products from our direct segment and fulfillment partner segment are available to both consumers and businesses through our Wholesale bulk purchase program.

*Direct business*

Our direct business includes sales made to individual consumers and businesses, which are fulfilled from our warehouses in Salt Lake City, Utah or our outsourced warehouses located in Plainfield, Indiana. During the quarter ended March 31, 2007, we fulfilled approximately 25% of all orders through our warehouses. Our warehouses generally ship between 5,000 and 8,000 orders per day, and up to approximately 34,000 orders per day during peak periods, using overlapping daily shifts.

*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 assume the risk of loss on the returned items. As a consequence, we record revenue from the majority of these sales transactions involving our fulfillment partners 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 fulfillment partner relationships with approximately 485 third parties which post approximately 26,000 non-BMMG products, as well as most of the BMMG products on our Websites.

Our revenue from sales on our shopping site from both the direct and fulfillment partner businesses is recorded net of returns, coupons and other discounts. Our returns policy for products other than those sold in our Electronics and Computers department provides for a $4.95 restocking fee and the provision that we will accept product returns initiated within thirty days after the shipment date. We charge a 15% restocking fee (instead of the $4.95 restocking fee) on all items returned for non-defective reasons from the Electronics and Computers department.

Unless otherwise indicated or required by the context, the discussion herein of our financial statements, accounting policies and related matters, pertains to our shopping sites (Shopping and BMMG) and not necessarily to our wholesale, auction, or cars tabs on our Websites.

*Wholesale business*

In August 2004, we merged our B2B site (www.overstockb2b.com) into our B2C site, and during 2005, we integrated this into our Wholesale tab, which allows consumers and businesses to purchase selected products in bulk quantities. For this tab, we have added a number of suppliers specific to various industry verticals, such as florist supplies, restaurant supplies, and office supplies.

*Auctions business*

We operate an online auction service as part of our Website. Our auction tab allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. For these sales we record only our listing fees and commissions for items sold as revenue. From time to time, we also sell items returned from our shopping site on our auction site, and for these sales, we record the revenue on a gross basis. Revenue from our auction business is included in the fulfillment partner segment, as it is not significant enough to segregate as its own segment.

*Cars listing business*

We operate an online site for listing cars for sale as a part of our Website. The cars 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. Revenue from our cars listing business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

*Cost of goods sold*

Cost of goods sold consists of the cost of the product, as well as inbound and outbound freight, warehousing and fulfillment costs (including payroll and related expenses), credit card fees, customer service costs and stock-based compensation.

*Operating expenses*

Sales and marketing expenses consist primarily of advertising, public relations and promotional expenditures, as well as payroll and related expenses, including stock-based compensation, for personnel engaged in marketing and selling activities.

Advertising expense is the largest component of our sales and marketing expenses and is primarily attributable to expenditures related to online marketing activities and offline national radio and television advertising. For the three months ended March 31, 2006 and 2007, our advertising expenses totaled approximately $12.5 million and $10.6 million, respectively, representing 98% and 94%, respectively, of sales and marketing expenses.

Technology expenses consist of wages and benefits, including stock-based compensation, for technology personnel, rent, utilities, connectivity charges, as well as support and maintenance and depreciation and amortization related to software and computer equipment.

General and administrative expenses consist of wages and benefits, including stock-based compensation, for executive, legal, accounting, merchandising and administrative personnel, rent and utilities, travel and entertainment, depreciation and amortization of intangible assets and other general corporate expenses.

We have recorded no provision or benefit for federal and state income taxes as we have incurred net operating losses since inception. We have provided a full valuation allowance on the net deferred tax assets, consisting primarily of net operating loss carryforwards, because of uncertainty regarding their realizability.

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

**Executive Commentary**

This executive commentary is intended to provide investors with a view of our business through the eyes of our management. As an executive commentary, it necessarily focuses on selected aspects of our business. This executive commentary is intended as a supplement to, but not a substitute for, the more detailed discussion of our business included elsewhere herein. Investors are cautioned to read our entire Management s Discussion and Analysis of Financial Condition and Results of Operations , as well as our interim and audited financial statements, and the discussion of our business and risk factors and other information included elsewhere in this report. This executive commentary includes forward-looking statements, and investors are cautioned to read the Special Note Regarding Forward-Looking Statements included elsewhere in this report.

*Commentary Revenue and Marketing.* Our first quarter revenue declined 11% from the first quarter of 2006. We believe that this decrease is primarily the result of a reduction in traffic to the Website due to a significant reduction in marketing expense as a percent of sales in the quarter (7.1%) compared to the previous two quarters (11.0% and 9.8%, respectively).

We believe that the keys to future revenue growth are to increase our Website conversion rate defined as the percentage of visitors to the website who make a purchase. The areas of our business that most directly affect conversion rate are personalization of the website, customer retention, e-mail marketing, site design and layout, and product selection. Within each of these areas, we have identified and made progress on initiatives that we believe can improve conversion, including an initiative to significantly increase the number of products within the existing stores on our Website by adding fulfillment partners that will enhance our current product offering.

*Commentary Gross Margins.* Our gross margins reached an all-time high of 16.0% in the first quarter. We significantly cleaned and reduced our inventory over the course of 2006 in an effort to refine the selection of products that we purchase directly to categories that turn faster and have higher profitability. We believe that we can run our direct business with significantly less inventory than we have had in the past, while filling in product selection using fulfillment partners, rather than acquiring the inventory directly. As a result of these efforts, we saw a significant improvement in direct and overall gross margins beginning in the first quarter of 2007. With reduced inventory levels, we have excess warehouse capacity, and therefore we have begun reducing our warehouse space, and the related costs, which will assist in our efforts to further improve our direct gross margins.

*Commentary Contribution and Contribution Margin*. Contribution is defined as gross profit dollars less sales and marketing expense. Although sales were down 11%, we were able to increase contribution dollars by $2.9 million (or 26%) to $14.0 million this year versus $11.1 million recorded during the same quarter in 2006. This was due to the improvements we made in gross margins (up 270 basis points to 16.0%) and a $1.4 million reduction in sales and marketing dollars spent. This equates to contribution margin of 8.9% this year versus 6.2% in 2006. Our long-term goal is to achieve a 15% contribution margin.

*Commentary Technology and G&A costs.* With revenue declining, we have begun efforts to decrease our operating expenses. We have reduced our headcount from 864 at December 2006 to 698 at the end of March 2007. We terminated a long-term computer co-location facility lease in December 2006. We are in the process of significantly reducing additional facilities and warehouse lease costs and other expenses, including the reduction of space in our corporate offices. Although our combined technology and G&A costs in the first quarter were up slightly year-over-year, we expect these costs to decrease overall in 2007.

*Commentary Balance Sheet Items.* We ended the first quarter with just under $17 million of inventory, significantly lower than the $81 million of inventory we had at the end of the first quarter of 2006, and down from $20 million at the end of 2006. From this lower inventory level, we were able to turn our inventory much more efficiently in the first quarter, while maintaining more attractive, higher margin products.

We ended the quarter with $68 million in cash, and added $11 million more in April as part of the proceeds from the sale of our OTravel subsidiary (see Financial Statements - Note 4). We anticipate that we will require less capital to run our business in the near future than we required in the recent past. However, whether we will need to raise additional capital will depend on, among other things, our revenues, gross margins, product sales mix and expenses.

The balance of our Management s Discussion and Analysis of Financial Condition and Results of Operations provides further information about the matters discussed above and other important matters affecting our business.

**Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies are as follows:

- revenue recognition;
- estimating valuation allowances and accrued liabilities, specifically, the reserve for returns, the allowance for doubtful accounts and the reserve for obsolete and damaged inventory;
- internal use software;
- accounting for income taxes;
- valuation of long-lived and intangible assets and goodwill; and
- stock based compensation and performance share plan.

*Revenue recognition.* We derive our revenue primarily from two sources: (i) direct revenue, which consists of merchandise sales made to consumers and businesses that are fulfilled from our warehouses; and (ii) fulfillment partner revenue, which consists of revenue from the sale of merchandise supplied and shipped by fulfillment partners directly to consumers and other businesses. This also includes listing fees and commissions collected from products being listed and sold through the Auctions tab of our Website as well as advertisement revenue derived from our cars listing business. All sources of revenue are recorded net of returns, coupons redeemed by customers, and other discounts. Revenues from our auction services and cars listing business were not material during the three months ended March 31, 2006 and 2007, and therefore are included in fulfillment partner revenue.

We record revenue from the majority of these sales transactions involving our fulfillment partners (excluding auctions) on a gross basis. Similar to our direct revenue segment, fulfillment partner products are available to both consumers and businesses.

For sales transactions, we comply with the provisions of Staff Accounting Bulletin 104 Revenue Recognition , which states that revenue should be recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped or the service provided and the customer takes ownership and assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. We generally require payment by credit card at the point of sale. Amounts received prior to when we ship the goods or provide the services to customers are recorded as deferred revenue. In addition, amounts received in advance for gift cards, Club O memberships and marketing royalties related to our co-branded credit card program are recorded as deferred revenue and recognized in the period earned.

*Reserve for returns, allowance for doubtful accounts and the reserve for obsolete and damaged inventory.* Our management must make estimates of potential future product returns related to current period revenue. Management analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns reserve and other allowances in any accounting period. The reserve for returns was $3.6 million and $1.3 million as of December 31, 2006 and March 31, 2007, respectively.

From time to time, we may grant credit to certain of our business customers on normal credit terms (typically 30 days). We perform ongoing credit evaluations of our customers financial condition and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectibility of all accounts receivable. We maintained an allowance for doubtful accounts receivable of $2.1 million and $1.8 million as of December 31, 2006 and March 31, 2007, respectively.

We write down our inventory for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated 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 reserve represents the new cost basis of such products. Reversal of these reserves is recognized only when the related inventory has been sold or scrapped. At December 31, 2006, our inventory balance was $20.3 million, net of allowance for obsolescence or damaged inventory of $6.6 million. At March 31, 2007, our inventory balance was $16.7 million, net of allowance for obsolescence or damaged inventory of $6.5 million.

*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 websites and processes supporting our business. As required by Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, we capitalize costs incurred during the application development stage of internal-use software and amortize these costs over the estimated useful life of three years. Costs incurred related to design or maintenance of internal-use software are expensed as incurred.

During the three months ended March 31, 2006 and 2007, we capitalized $8.1 million and $1.3 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $559,000 and $776,000 for those respective periods.

*Accounting for income taxes.* Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. As of December 31, 2006 and March 31, 2007, we have recorded a full valuation allowance of $74.4 million and $81.1 million, respectively, against our net deferred tax asset balance due to uncertainties related to our deferred tax assets as a result of our history of operating losses. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to change the valuation allowance, which could materially impact our financial position and results of operations.

*Valuation of long-lived and intangible assets and goodwill.* Under SFAS 142, *Goodwill and Other Intangible Assets*, goodwill is not amortized, but must be tested for impairment at least annually. Other long-lived assets must also be evaluated for impairment when management believes that an asset has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the asset that may not be reflected in an asset s current carrying value, thereby possibly requiring an impairment charge in the future. Goodwill totaled $2.8 million as of December 31, 2006 and March 31, 2007.

In conjunction with the decision to sell OTravel, our travel subsidiary, we performed an evaluation of its goodwill, pursuant to SFAS 144, *Accounting for the Impairment Long-Lived Assets*, and SFAS 142, *Goodwill and Other Intangible Assets,* and determined that goodwill was subject to an impairment loss of approximately $4.5 million during year ended December 31, 2006 and $3.8 million during the three months ended March 31, 2007 (see Financial Statements Note 4 Discontinued Operations ). These have been recorded as a component of the loss from discontinued operations.

*Stock-based compensation.* As of January 1, 2006, we adopted SFAS 123(R), which requires us to measure compensation cost for all outstanding unvested share-based awards at fair value and recognize compensation over the service period for awards expected to vest. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our 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, employee class, and historical experience. Actual results may differ substantially from these estimates. We have utilized a Black-Scholes-Merton valuation model to estimate the value of stock options granted to employees. Several of the primary estimates used in measuring stock-based compensation are as follows:

*Expected Volatility:* The fair value of stock options were valued using a volatility factor based on the Company s historical stock prices.

*Expected Term:* The Company s expected term represents the period that the Company s stock options are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms and vesting provisions of the stock-based awards.

*Expected Dividend:* The Company has not paid any dividends and does not anticipate paying dividends in the foreseeable future.

*Risk-Free Interest Rate:* The Company bases the risk-free interest rate used on the implied yield currently available on U.S. Treasury zero-coupon issues with remaining term equivalent to the expected term of the options.

*Estimated Pre-vesting Forfeitures:* When estimating forfeitures, the Company considers voluntary and involuntary termination behavior.

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

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

Approximately $400,000 and $250,000 of compensation expense under the plan has been included in general and administrative expenses for the quarters ended March 31, 2006 and 2007, respectively. As of March 31, 2007, we have accrued $1.2 million in total compensation expense under the plan.

*Recent Accounting Pronouncements.*

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

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return.

We adopted the provisions of FIN 48, on January 1, 2007. As a result of a full valuation allowance, we do not have any unrecognized tax benefits and there is no effect on our financial condition or results of operations as a result of implementing FIN 48. We are subject to audit by the IRS and various states for the prior 3 years. We do not believe there will be any material changes in its unrecognized tax positions over the next 12 months. Our policy is that we recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the quarter ended March 31, 2007.

We recognized no income tax benefit from the net loss generated in the three months ended March 31, 2006 and 2007. Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes*, requires that a valuation allowance be provided if it is more likely than not that some portion or all of a deferred tax asset will not be realized. Our ability to realize the benefit of its deferred tax asset will depend on the generation of future taxable income through profitable operations. As of March 31, 2007, we have established a full valuation allowance against it deferred tax assets.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements. We will adopt SFAS 157 on January 1, 2008. We anticipate that the adoption of SFAS 157 will not have a material impact on our consolidated financial statements.

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

**Results of Operations**

The following table sets forth our results of operations expressed as a percentage of total revenue for the three months ended March 31, 2006 and 2007.

| | **Three months ended March 31,** | |
|---|---|---|
| | **2006** | **2007** |
| | **(as a percentage of total revenue)** | |
| Revenue | | |
| Direct revenue | 44.8% | 28.9% |
| Fulfillment partner revenue | 55.2 | 71.1 |
| Total revenue | 100.0 | 100.0 |
| Cost of goods sold | | |
| Direct | 39.7 | 24.9 |
| Fulfillment partner | 47.0 | 59.1 |
| Total cost of goods sold | 86.7 | 84.0 |
| Gross profit | 13.3 | 16.0 |
| Operating expenses: | | |
| Sales and marketing | 7.1 | 7.1 |
| Technology | 7.5 | 9.5 |
| General and administrative | 6.7 | 6.8 |
| Restructuring | | 3.8 |
| Total operating expenses | 21.3 | 27.2 |
| Operating loss | (8.0) | (11.2) |
| Interest income, net | 0.2 | 0.6 |
| Interest expense | (0.7) | (0.6) |
| Other (expense) income, net | | |
| Loss from continuing operations | (8.5)% | (11.2)% |

**Comparison of Three Months Ended March 31, 2006 and 2007**

**Revenue**

During the three months ended March 31, 2006 and 2007, total revenue decreased 11%, from $178.0 million in 2006 to $157.9 million in 2007. During the same period, direct revenue decreased 43%, from $79.7 million in 2006 to $45.7 million in 2007, while fulfillment partner revenue experienced 14% growth, from $98.3 million in 2006 to $112.2 million in 2007. We believe that the decrease in total revenue is primarily the result of a reduction in traffic to the Website due to a significant reduction in marketing expenditures as a percent of sales in the quarter (7.1%) compared to the previous two quarters (11.0% and 9.8%, respectively). In addition, because we have been able to significantly decrease our inventory over the past twelve months (from $81 million at the end of Q1 2006 compared to less than $17 million this year), our sales mix has shifted more to our fulfillment partner business.

We believe that the keys to future revenue growth are to increase our Website conversion rate defined as the percentage of visitors to the website who make a purchase and to significantly increase the number of products available on our Website by increasing the number of fulfillment partners selling product on our site. The areas of our business that most directly affect conversion rate are personalization of the website, customer retention, e-mail marketing, and site design and layout. Within each of these areas, we have identified and made progress on initiatives that we believe can improve conversion, including outsourcing to third-party providers certain aspects of the functionality on the website, including the engine that provides product recommendations to customers visiting product pages and the gift center on our Website. To significantly increase the product offering available for our customers, we are in the process of integrating with a third-party provider that will provide the technology to give additional fulfillment partners the ability to sell product on our site.

**Gross Margin**

Total Gross Margin For the three months ended March 31, 2006 and 2007, total cost of goods sold decreased $21.7 million or 14%, from $154.3 million in 2006 to $132.6 in 2007, resulting in a 7% increase in gross profits (from $23.8 million in 2006 to $25.3 million in 2007). As a percent of total revenue, cost of goods sold decreased from 87% to 84% for those respective periods, resulting in increased gross margins of 13.3% and 16.0% for the three months ended March 31, 2006 and 2007, respectively.

Cost of goods sold also included stock-based compensation related to the adoption of SFAS 123(R) of $96,000 and $107,000 during the three months ended March 31, 2006 and 2007, respectively.

Generally, our overall gross margins fluctuate based on several factors, including our product mix of sales; sales volumes mix by our direct business and fulfillment partners; changes in vendor pricing; lowering prices for customers, including competitive pricing and inventory management decisions within the direct business; warehouse management costs; customer service costs; and our discounted shipping offers. Discounted shipping offers reduce shipping revenue, and therefore reduce our gross margins on retail sales.

Direct Gross Margins For the three months ended March 31, 2006 and 2007, gross profits for our direct business decreased 29% from $9.0 million in 2006 to $6.4 million in 2007. However, gross margins for our direct business increased from 11.2% to 13.9% for those respective periods. The lower gross profits are the result of direct revenue being down 43% from last year, primarily due to a significant reduction in direct inventory. However, gross margins have increased at the same time, since the remaining inventory in general turns faster and has higher profitability.

Fulfillment Partner Gross Margins For the three months ended March 31, 2006 and 2007, our fulfillment partner business generated gross profits of $14.7 million and $18.9 million, respectively, an increase of 28%. This increase in gross profit dollars is the result of the 14% increase in fulfillment partner sales combined with increased gross margins, from 15.0% to 16.8% for those respective periods. The increase in partner gross margins is the result of better product pricing and improvements in the cost of operations, including customer service.

**Fulfillment costs**

Fulfillment costs include all warehousing costs, including fixed overhead and variable handling costs (excluding packaging costs), as well as credit card fees and customer service costs, all of which we include as costs in calculating gross margins. We believe that some companies in our industry, including some of our competitors, account for fulfillment costs within operating expenses, and therefore exclude fulfillment costs from gross margins. As a result, our gross margins may not be directly comparable to others in our industry.

The following table has been included to provide investors additional information regarding our classification of fulfillment costs and gross margins, thus enabling investors to better compare our gross margins with others in our industry:

| | Three months ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | | 2006 | | | 2007 | |
| Total revenue | $ | 178,044 | 100% | $ | 157,930 | 100% |
| Cost of goods sold | | | | | | |
| Product costs and other cost of goods sold | | 138,065 | 78% | | 121,532 | 77% |
| Fulfillment costs | | 16,225 | 9% | | 11,083 | 7% |
| Total cost of goods sold | | 154,290 | 87% | | 132,615 | 84% |
| Gross profit | $ | 23,754 | 13% | $ | 25,315 | 16% |

As displayed in the above table, fulfillment costs during the three months ended March 31, 2006 and 2007 were $16.2 million and $11.1 million, respectively, or 9.1% and 7.0% of total revenue for those respective periods. Fulfillment costs as a percentage of sales may vary due to several factors, such as our ability to manage costs at our warehouses, significant changes in the number of units received and fulfilled, the extent we utilize third party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees.

**Operating expenses**

*Sales and marketing.* For the three months ended March 31, 2006 and 2007, sales and marketing expenses totaled $12.7 million and $11.3 million (11% decrease), respectively. Our marketing expense is variable and is measured as a percentage of overall revenue. Sales and marketing expenses were flat year-over-year as a percentage of sales at 7%. We direct customers to our Websites primarily through a number of targeted online marketing channels, such as sponsored search, affiliate marketing, portal advertising, e-mail campaigns, and other initiatives. We also utilize channels such as nation-wide television, print and radio advertising campaigns.

While costs associated with our discounted shipping promotions are not included in marketing expense (they are accounted for as a reduction of revenue), we consider discounted shipping promotions as an effective marketing tool, and intend to continue to offer them as we deem appropriate.

Sales and marketing expenses also included stock-based compensation related to the adoption of SFAS 123(R) in 2006 of $70,000 and $78,000 during the three months ended March 31, 2006 and 2007, respectively.

*Technology expenses.* Technology expenses increased 12%, from $13.4 million for the three months ended March 31, 2006, to $15.0 million for the same period in 2007, representing 8% and 10% of total revenue for those respective periods. Technology expenses also included stock-based compensation related to the adoption of SFAS 123(R) in 2006 of $159,000 and $177,000 during the three months ended March 31, 2006 and 2007, respectively.

The year-over-year increase in technology expenses relates to increased depreciation expense. Although these costs are up from the first quarter of last year, we believe that they have now stabilized, and expect them to begin to decrease in 2008 as depreciation expense goes down.

*General and administrative expenses.* General and administrative ( G&A ) expenses decreased 10%, from $11.9 million to $10.7 million during the three months ended March 31, 2006 and 2007, respectively, representing approximately 7% of total revenue for each of the respective periods. We incurred stock-based compensation within general and administrative expenses of approximately $633,000 and $711,000 for the three months ended March 31, 2006 and 2007, respectively. The decrease in G&A expenses this quarter relates to decreases in payroll-related expenses, professional fees, merchandising, legal and finance costs as we have made reductions to our corporate headcount over the past six months.

A large portion of our technology and general and administrative expenses are non-cash expenses. Total depreciation and amortization (including amortization of stock-based compensation) during the first quarter of 2007 was $8.9 million, and we estimate that total depreciation and amortization in 2007 will be approximately $35 - $40 million. This compares to similar non-cash depreciation and amortization expense of $8.8 million for the three months ended March 31, 2006.

*Restructuring expenses.* During the fourth quarter of 2006, we commenced implementation of a facilities consolidation and restructuring program designed to reduce our overall expense structure in an effort to improve future operating performance. The facilities consolidation and restructuring program should be substantially completed during calendar year 2007 (see Financial Statements Note 3 Restructuring Expenses ).

In the first quarter of 2007, we terminated a logistics services agreement and gave notice of our intent to sublease vacated warehouse facilities in Indiana and accrued $4.6 million of charges. We also recorded an additional $954,000 of restructuring charges related to accelerated amortization of leasehold improvements in our current corporate office facilities that we are attempting to sublease, and $487,000 of other miscellaneous restructuring charges, including costs related to the reduction of data center space and corporate headcount.

**Non-operating income (expense)**

*Interest income, interest expense and other income (expense).* Interest income derived from the investment of our excess cash in short-term investments was $315,000 and $990,000 for the three months ended March 31, 2006 and 2007, respectively. This is due to both an increase in total cash and in interest rates in 2007 from 2006.

Interest expense is largely related to our convertible notes, capital leases and our credit lines. Interest expense decreased slightly from $1.3 million during the three months ended March 31, 2006 to $1.0 million during the same period in 2007. The decrease in interest expense is due to the fact that we had $20 million of borrowings outstanding on our inventory line of credit in the first quarter of 2006, and no borrowings outstanding during the same period in 2007.

Under SFAS No. 133, the Foreign Notes were considered to be derivative financial instruments and were marked to market quarterly. Any unrealized gain or loss related to the changes in value of the conditional coupon was recorded in the income statement as a component of interest income or expense. Any unrealized gain or loss related to the changes in the value of the Notes was recorded as a component of other comprehensive income (loss). On April 26, 2006, we sold the Foreign Notes for $49.5 million, resulting in the gain on the bond instrument of $1.9 million (see Financial Statements Note 5 Marketable Securities ).

**Discontinued operations**

As part of the program to reduce our expense structure and sell non-core businesses, we decided during the fourth quarter of 2006 to sell our travel subsidiary ( OTravel ). As a result, OTravel s operations have been classified as a discontinued operation and therefore are not included in the results of continuing operations. The loss from discontinued operations for OTravel was $779,000 and $3.6 million for the three months ended March 31, 2006 and 2007, respectively.

In addition, we have classified $15.0 million of assets and $993,000 of liabilities as held for sale related to the management s decision to market and sell the OTravel subsidiary. In conjunction with the discontinuance of OTravel, we performed an evaluation of the goodwill associated with the reporting unit pursuant to SFAS 142, and SFAS 144, *Accounting for the Impairment of Long-Lived Assets* and determined that goodwill of approximately $4.5 million was impaired as of December 31, 2006 based on a non-binding letter of intent from a third party to purchase this business. On April 25, 2007, we completed the sale of OTravel for $11.0 million of cash and $6.0 million of notes. Based on the estimated fair value of the discounted cash flows of the net proceeds from the sale, we recorded an additional goodwill impairment of $3.8 million as of March 31, 2007 (see Financial Statements Note 4 Discontinued Operations ).

**Income taxes**

*Income taxes.* For the three months ended March 31, 2006 and 2007, we incurred net operating losses, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2006 and March 31, 2007, we had net operating loss carryforwards of approximately $145.2 million and $166.7 million, respectively, which may be used to offset future taxable income. An additional $15.9 million of net operating losses are limited under Internal Revenue Code Section 382 to $799,000 a year. These net operating loss carryforwards will begin to expire in 2018.

**Seasonality**

Based upon the Company s historical experience, increased revenues typically occur during the fourth quarter because of the Christmas retail season. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect the Company s results of operations in the future. The following table reflects the Company s revenues for each of the quarters since 2004 (in thousands):

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| 2007 | $ 157,930 | | | |
| 2006 | 178,044 | $ 159,192 | $ 156,885 | $ 294,029 |
| 2005 | 165,881 | 150,638 | 167,779 | 315,018 |
| 2004 | 82,078 | 87,792 | 103,444 | 221,321 |

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that would be material to investors.

**Liquidity and Capital Resources**

Prior to the second quarter of 2002, we financed our activities primarily through a series of private sales of equity securities, warrants to purchase our common stock and promissory notes. During the second quarter of 2002, we completed our initial public offering pursuant to which we received approximately $26.1 million in cash, net of underwriting discounts, commissions, and other related expenses. Additionally, we completed follow-on offerings in February 2003, May 2004 and November 2004, pursuant to which we received approximately $24.0 million, $37.9 million and $75.2 million, respectively, in cash, net of underwriting discounts, commissions, and other related expenses. In November 2004, we also received $116.2 million in proceeds from the issuance of our convertible senior notes in a transaction event exempt from registration under the Securities Act. During 2006, we received $64.4 million from two stock offerings in May and December. At March 31, 2007, our cash and cash equivalents balance was $68.1 million.

Our operating activities resulted in net cash outflows of $72.6 million and $58.2 million for the three months ended March 31, 2006 and 2007, respectively. We have payment terms with our fulfillment partners that extend beyond the amount of time necessary to collect proceeds from our customers. As a result, following our seasonally strong fourth quarter sales, at

December 31 of each year, our cash, cash equivalents, marketable securities and accounts payable balances typically reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). However, our accounts payable balance normally declines during the first three months following year-end, which normally results in a decline in our cash, cash equivalents, and marketable securities balances in the first quarter each year.

The primary use of cash and cash equivalents during the three months ended March 31, 2006 was to fund our operations, including net losses of $15.9 million (which includes $779,000 of loss from discontinued operations and $8.1 million of other net non-cash activity), as well as changes in prepaid expenses, accounts payables and accrued liabilities of $1.9 million, $63.6 million and $15.2 million, respectively. This was offset by the cash provided from changes in accounts receivable, inventory, prepaid inventory and other long-term assets of $2.3 million, $11.9 million, $794,000 and $47,000, respectively. For the three months ended March 31, 2007, the primary use of cash and cash equivalents was to fund our operations, including net losses of $21.4 million (which includes $3.6 million of loss from discontinued operations, $6.1 million of non-cash restructuring costs and $9.5 million of other net non-cash activity), as well as changes in prepaid inventory, prepaid expenses, accounts payables and accrued liabilities of $360,000, $2.0 million, $38.1 million and $23.3 million, respectively. This was offset by the cash provided from changes in accounts receivable, inventory and other long-term assets of $3.8 million, $3.6 million and $90,000, respectively.

Investing activities resulted in cash inflows of $575,000 and $3.5 million for the three months ended March 31, 2006 and 2007, respectively. The cash inflows from investing activities in 2006 primarily resulted from the sale of marketable securities of $7.3 million, offset by expenditures for property and equipment of $6.8 million. Cash inflows from investing activities in 2007 resulted from cash received from the payments totaling $3.9 million on a note receivable given in consideration for our variable interest entity, offset by expenditures for property and equipment of $447,000.

Financing activities resulted in cash inflows of $18.6 million and cash outflows of $4.1 million during the three months ended March 31, 2006 and 2007, respectively. The cash inflow of $18.6 million in 2006 was primarily the result of net cash received from net borrowings on our inventory line of credit of $20.0 million and cash received from the exercise of stock options and warrants. Cash outflow for financing activities in 2007 was primarily from capital lease payments of $5.2 million, offset by $1.2 million of proceeds from the exercise of stock options.

Certain prior-year amounts have been reclassified to conform to the current year s financial statement presentation. In addition, we have revised our consolidated statements of cash flows for the year ended December 31, 2006 to present the operating and investing portion of the cash flows attributable to discontinued operations on a separately identifiable basis.

While we believe that the cash and marketable securities currently on hand, amounts available under our credit facility and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months, we may require additional financing. However, there can be no assurance that if additional financing is necessary it will be available, or, if available, that such financing can be obtained on satisfactory terms. Failure to generate sufficient revenues, generate profitability or raise additional capital could have a material adverse effect on our ability to continue as a going concern and to achieve our intended business objectives. Any projections of future cash needs and cash flows are subject to substantial uncertainty.

*Contractual Obligations and Commitments.* The following table summarizes our contractual obligations as of March 31, 2007 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods:

**Payments Due by Period**

| Contractual Obligations | Total | Less than 1 Year | 1-3 Years (in thousands) | 4-5 Years | After 5 years |
|---|---|---|---|---|---|
| Long-term debt arrangements | $ 77,000 | $ | $ | $ 77,000 | $ |
| Interest on convertible senior notes | 14,438 | 3,609 | 5,775 | 5,054 | |
| Capital lease obligations | 3,810 | 3,810 | | | |
| Operating leases | 48,940 | 11,041 | 12,245 | 10,769 | 14,885 |
| Purchase obligations | 18,586 | 18,586 | | | |
| Line of credit | | | | | |
| Total contractual cash obligations | $ 162,774 | $ 37,046 | $ 18,020 | $ 92,823 | $ 14,885 |

| Other Commercial Commitments | Total Amounts Committed | Amounts of Commitment Expiration Per Period | | | |
|---|---|---|---|---|---|
| | | Less than Year 1 | 1-3 Years (in thousands) | 4-5 Years | Over 5 years |
| Letters of credit | $ 8,315 | $ 8,315 | $ | $ | $ |
| Redeemable common stock | | | | | |
| Total commercial commitments | $ 8,315 | $ 8,315 | $ | $ | $ |

*3.75% Convertible Senior Notes*

In November 2004, we completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes ). Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness. The Senior Notes are convertible at any time prior to maturity into our common stock at the option of the note holders at a conversion price of $76.23 per share (subject to adjustment in certain events, including stock splits, dividends and other distributions and certain repurchases of our stock, as well as certain fundamental changes in the ownership of the Company).

Beginning December 1, 2009, we have the right to redeem the Senior Notes, in whole or in part, for cash at 100% of the principal amount plus accrued and unpaid interest. Upon the occurrence of a fundamental change (including the acquisition of a majority interest in the Company, certain changes in the Company s board of directors or the termination of trading of our stock) meeting certain conditions, holders of the Senior Notes may require us to repurchase for cash all or part of their notes at 100% of the principal amount plus accrued and unpaid interest.

In 2005, under the Share Repurchase Program discussed below, we retired $43.0 million of the Senior Notes for $35.7 million in cash. As a result of the note retirements, we recognized a gain of $6.2 million, net of the associated unamortized discount of $1.2 million for the year ended December 31, 2005. As of March 31, 2007, $77.0 million of Senior Notes and unamortized debt discount of $1.6 million remain outstanding.

*Lease and Purchase Obligations*

The lease obligations include our obligations under a ten-year lease agreement we entered in December 2004 for approximately 154,000 square feet of office space in Salt Lake City. We took possession of the new office space in July of 2005, and terminated our lease obligations under our previous office lease agreements at the same time. The total lease obligation over the ten-year term of the new lease is $39.6 million, of which approximately $4.2 million is payable in the next twelve months. In connection with the preparation of the new office space, we provided a letter of credit for $500,000 to provide funds for the removal of the improvements upon termination of the new sublease.

In November 2006, we made the determination to consolidate our facilities and began marketing of the office facilities lease for sub-lease. We recorded a liability of $450,000 for the costs to dismantle and dispose of an escalator system and to the return the leased facilities to their original condition (see Financial Statements Note 3 Restructuring Expense ) and incurred additional depreciation in connection with the revised useful life of certain leasehold improvements.

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

In July 2004, we entered into a logistics service agreement (the Logistics Agreement ) wherein the handling, storage and distribution of our prepackaged products is performed by a third party within 425,000 square feet in Indiana. The Logistics Agreement and subsequent amendment set forth terms on which we paid various fixed fees based on square feet of storage and various variable costs based on product handling costs for a term of five years. In February we gave a six-month notice of termination of this agreement. We estimate the termination costs of this agreement at approximately $1.4 million, payable in August 2007, which costs include prepayment of 6 months of fees under the agreement and payment of costs associated with improvement and equipment removal (see Financial Statements Note 3 Restructuring Expense ).

In December 2005, we entered into a warehouse facilities lease agreement (the License Agreement ) to license approximately 400,000 square feet of warehouse space in Indiana. The License Agreement was subsequently amended, reducing the amount of lease space to approximately 300,000 and extended the term to 2011. In February 2007 we made the determination to close our Indiana warehouse operations. As a result, our Indiana landlord has agreed to allow a sublease or assumption of the lease on the remaining 300,000 square feet. We are currently advertising for another tenant or tenants to assume or sublease. We have estimated the net cost over the remaining life of this lease (net of any amounts we may receive from sublease) to be $3.2 million (see Financial Statements Note 3 Restructuring Expense ).

We lease 610,000 square feet of warehouse facilities in Utah under operating leases which expire in August 2012.

The amount of purchase obligations shown is based on assumptions regarding the legal enforceability against us of purchase orders we had outstanding at March 31, 2007. Under different assumptions regarding our rights to cancel our purchase orders or different assumptions regarding the enforceability of the purchase orders under applicable law, the amount of purchase obligations shown in the table above would be less.

*Borrowings*

*$30.0 million Amended Credit Agreement*

On October 18, 2005, the Company entered into a sixth amendment to a credit agreement (as amended to date, the Amended Credit Agreement ) with Wells Fargo Bank, N.A. The Amended Credit Agreement provides a revolving line of credit to the Company of up to $30.0 million which we use primarily to obtain letters of credit to support inventory purchases. Borrowings and outstanding letters of credit under the credit agreement are collateralized by cash balances held at Wells Fargo Bank, N.A. The Amended Credit Agreement expires on December 31, 2007, however, we have an option to renew the Amended Credit Agreement annually. Interest on borrowings is payable monthly and accrued at either (i) 1.35% above LIBOR in effect on the first day of an applicable fixed rate term, or (ii) at a fluctuating rate per annum determined by the bank to be one half a percent (0.50%) above daily LIBOR in effect on each business day a change in daily LIBOR is announced by the bank. Unpaid principal, together with accrued and unpaid interest is due on the maturity date.

The Amended Credit Agreement requires us to comply with certain covenants, including restrictions on mergers, business combinations or transfer of assets. We were in compliance with these covenants at March 31, 2007.

At March 31, 2007, no amounts were outstanding under the Amended Credit Agreement, and letters of credit totaling $8.3 million were issued on our behalf.

*$40.0 million WFRF Agreement*

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

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

Advances under the WFRF Agreement bear interest at either (a) the rate announced, from time to time, within Wells Fargo Bank, N.A. at its principal office in San Francisco as its prime rate or (b) a rate based on LIBOR plus a varying percentage between 1.25% and 1.75%; however, the annual interest rate on advances under the WFRF Agreement will be at least 3.50%. The WFRF Agreement includes affirmative covenants as well as negative covenants that prohibit a variety of actions without the lender s approval, including covenants that limit our ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another person, (d) sell assets, (e) change our name or the name of any of our subsidiaries, (f) make certain changes to our business, (g) optionally prepay, acquire or refinance indebtedness, (h) consign inventory, (i) pay dividends on, or purchase, acquire or redeem shares of, our capital stock, (j) change our method of accounting, (k) make investments, (l) enter into transactions with affiliates, or (m) store any of our inventory or equipment with third parties. We were in compliance with these covenants as of March 31, 2007. At March 31, 2007, no amounts were outstanding under the WFRF Agreement. As of March 31, 2007, availability under the WFRF Agreement was $6.2 million.

*Share Repurchase Program*

During January 2005, our Board of Directors authorized a share repurchase program under which we were authorized to repurchase up to $50.0 million of our common stock through December 31, 2007. On April 26, 2005, the Board of Directors increased the amount of the share repurchase program to $100.0 million. Additionally, on June 14, 2005, the Board of Directors authorized an amendment of our three-year share repurchase program to include the repurchase of our Convertible Senior Notes. Under the repurchase program, we repurchased approximately 665,000 shares of our common stock in open market transactions for $24.1 million during the year ended December 31, 2005. In addition, approximately 1.0 million shares of common stock were acquired as a result of the settlement of $41.1 million of structured stock repurchase transactions during the year ended December 31, 2005. The purchased call options that did not settle in stock settled in cash totaling $7.9 million, which we received in July 2005. We also repurchased convertible senior notes having an aggregate principal amount of $43.0 million during 2005. As of December 31, 2005, we have utilized all of the $100.0 million authorized by the board of directors under the share repurchase program.

*Shelf Registration*

In April 2005, we filed a registration statement with the Securities and Exchange Commission using a shelf registration or continuous offering process. Under this shelf process, we may, from time to time, sell any or all of the securities described in the prospectus in one or more offerings up to a total dollar amount of $500.0 million. On May 1, 2006, we issued approximately 1,042,000 shares of common stock for net proceeds of approximately $25.0 million. Additionally, on December 12, 2006, we issued approximately 2,734,000 shares for net proceeds of approximately $39.4 million.

**Government Regulation**

All of our services are subject to federal and state consumer protection laws including laws protecting the privacy of consumer non-public information and regulations prohibiting unfair and deceptive trade practices. In particular, under federal and state financial privacy laws and regulations, we must provide notice to consumers of our policies on sharing non-public information with third parties, must provide advance notice of any changes to our policies and, with limited exceptions, must give consumers the right to prevent sharing of their non-public personal information with unaffiliated third parties. Furthermore, the growth and demand for online commerce could result in more stringent consumer protection laws that impose additional compliance burdens on online companies. These consumer protection laws could result in substantial compliance costs and could interfere with the conduct of our business.

In many states, there is currently great uncertainty whether or how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet and commercial online services. These issues may take years to resolve. In addition, new state tax regulations may subject us to additional state sales and income taxes. New legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of existing laws and regulations to the Internet and commercial online services could result in significant additional taxes on our business. These taxes could have an adverse effect on our cash flows and results of operations. Furthermore, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements.

**Factors that May Affect Future Results**

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described in this Form 10-Q/A, and all other information in this Form 10-Q/A and in our other filings with the SEC including those we file after we file this Form 10-Q/A, before deciding whether to purchase or hold our securities. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in Item 1A of Part II of this Form 10-Q/A could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents, marketable securities, trade accounts and contracts receivable, accounts payable and long-term obligations.

We consider investments in highly-liquid instruments purchased with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents. Our exposure to market risk for changes in interest rates relates primarily to our short-term investments and short-term obligations; thus, fluctuations in interest rates would not have a material impact on the fair value of these securities.

At March 31, 2007, we had $68.1 million in cash and cash equivalents. A hypothetical increase or decrease in interest rates of one hundred basis points would have an estimated impact of approximately $680,000 on our earnings or loss, or the fair market value or cash flows of these instruments.

At March 31, 2007, we had approximately $77.0 million of convertible senior notes outstanding which bear interest at a fixed rate of 3.75%. In addition, at March 31, 2007, there were no borrowings outstanding under our lines of credit and letters of credit totaling $8.3 million were outstanding under our credit facilities.

The fair value of the convertible senior notes is sensitive to interest rate changes. Interest rate changes would result in increases or decreases in the fair value of the convertible senior notes, due to differences between market interest rates and rates in effect at the inception of the obligation. Unless we elect to repurchase our convertible senior notes in the open market, changes in the fair value of convertible senior notes have no impact on our cash flows or consolidated financial statements. The estimated fair value of our 3.75% Convertible Senior Notes of March 31, 2007 was $57.4 million.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to ensure that information relating to the Company and its consolidated subsidiaries required to be disclosed in the Company s periodic filings under the Securities Exchange Act of 1934, as amended (the Exchange Act ), is recorded, processed, summarized and reported in a timely manner in accordance with the requirements of the Exchange Act, and that such information is accumulated and communicated to management, including the Company s Chief Executive Officer (principal executive officer) and Senior Vice President, Finance (principal financial officer), as appropriate, to allow timely decisions regarding required disclosure. The Company carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer (principal executive officer) and Senior Vice President, Finance (principal financial officer), of the effectiveness of the design and operation of these disclosure controls and procedures, as such term is defined in Exchange Act Rule 13a-15(e), as of March 31, 2007. Based on this evaluation, the Chief Executive Officer (principal executive officer) and Senior Vice President, Finance (principal financial officer) each concluded that the Company s disclosure controls and procedures were effective as of March 31, 2007.

**Changes in Internal Control Over Financial Reporting**

There have been no changes in the Company s internal control over financial reporting that occurred during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

From time to time, we receive claims of and become subject to consumer protection, employment, intellectual property and other commercial litigation related to the conduct of our business. Such litigation could be costly and time consuming and could divert our management and key personnel from our business operations. The uncertainty of litigation increases these risks. In connection with such litigation, we may be subject to significant damages or equitable remedies relating to the operation of our business and the sale of products on our websites. Any such litigation may materially harm our business, prospects, results of operations, financial condition or cash flows. However, we do not currently believe that any of our outstanding litigation will have a material adverse effect on our financial statements.

In December 2003, we received a letter from Furnace Brook claiming that certain of our business practices and our website infringe a single patent owned by Furnace Brook. After diligent efforts to show that we do not infringe the patent and Furnace Brook s continual demands that we enter into licensing arrangements with respect to the asserted patent, on August 12, 2005, we filed a complaint in the United States District Court of Utah, Central Division, seeking declaratory judgment that we do not infringe any valid claim of the Furnace Brook patent. Furnace Brook filed a motion to dismiss our complaint for lack of personal jurisdiction over Furnace Brook in Utah. On October 31, 2005, the United States District Court of Utah, Central Division, issued a decision to dismiss our complaint for lack of personal jurisdiction over patent troll Furnace Brook. On December 14, 2005, we filed an appeal of the Utah decision with the United States Court of Appeals for the Federal Circuit. On August 18, 2006, the United States Court of Appeals for the Federal Circuit denied the Company s appeal. On August 18, 2005, shortly after we filed the complaint in Utah, Furnace Brook filed a complaint in the United States District Court for the Southern District of New York, alleging that certain of our business practices and our website infringe a single patent owned by Furnace Brook. On September 9, 2005, we filed an answer denying the material allegations in Furnace Brook s claims. On September 27, 2006, the United States District Court for the Southern District of New York issued a memorandum and order in a Markman Hearing which substantially adopted the Company s interpretation of the Furnace Brook patent. We filed motions for summary judgment relating to the litigation and on October 6, 2006, the United States District Court for the Southern District of New York heard oral argument on those motions and on October 30, 2006, the United States District Court for the Southern District of New York granted summary judgment in favor of us, ruling that we do not infringe the Furnace Brook patent as a matter of law. On November 9, 2006, Furnace Brook filed a notice of appeal to the United States Court of Appeals for the Federal Circuit. On January 16, 2007, we filed a brief with the Federal Circuit Court and the appeal is now pending.  Oral argument on the appeal is scheduled for May 10, 2007.

On August 11, 2005, along with a shareholder plaintiff, we filed a complaint against Gradient Analytics, Inc.; Rocker Partners, LP; Rocker Management, LLC; Rocker Offshore Management Company, Inc. and their respective principals in the Superior Court of California, County of Marin. On October 12, 2005, we filed an amended complaint against the same entities alleging libel, intentional interference with prospective economic advantage and violations of California s unfair business practices act. On March 7, 2006, the court denied the defendants demurrers to and motions to strike the amended complaint. The defendants each filed a motion to appeal the court s decision, we responded and the California Attorney General submitted an amicus brief supporting our view; the court has ruled that this appeal stays discovery in the case. On April 10, 2007, the California Court of Appeals heard oral argument on the appeal; the California Court of Appeals has not yet issued its decision. We intend to pursue this action vigorously.

On May 9, 2006 we received a notice of an investigation and subpoena from the Securities and Exchange Commission, Salt Lake City District Office. On May 17, 2006, Patrick Byrne also received a subpoena from the Securities and Exchange Commission, Salt Lake City District Office.  These subpoenas requested a broad range of documents, including, among other documents, all documents relating to our accounting policies, our targets, projections or estimates related to financial performance, our recent restatement of its financial statements, the filing of our complaint against Gradient Analytics, Inc., the development and implementation of certain new technology systems and disclosures of progress and problems with those systems, communications with and regarding investment analysts, communications regarding shareholders who did not receive the Company s proxy statement in April 2006, communications with certain shareholders, and communications regarding short selling, naked short selling, purchases and sales of our stock, obtaining paper certificates, and stock loan or borrow of our shares. We have and Mr. Byrne has responded to these subpoenas and each continues to cooperate with the Securities and Exchange Commission on this matter.

In November 2006, we received a letter from Applied Interactive, claiming that certain of our business practices and our website infringe two patents owned by Applied Interactive and offering to enter into a licensing agreement. After determining that we do not infringe the patents and rejecting the offered licensing agreement, on February 2, 2007, we filed a complaint in the United States District Court, Southern District of New York, seeking declaratory judgment that we do not infringe any valid claim of the Applied Interactive patents. We have reached a confidential agreement in principal with Applied Interactive to settle this matter for an immaterial amount. The parties will dismiss the suit with prejudice once this agreement has been memorialized.

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. The suit alleges 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 with in the nature and amount of trading in our stock as well as dramatic declines in the share price of the 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 the company s entire supply of outstanding shares. The suit accuses 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. We are seeking damages of $3.48 billion. The case is in its initial stages. We intend to vigorously prosecute this action.

On March 29, 2007, we, along with 63 other defendants, were sued in United States District Court for the Eastern District of Texas, Tyler Division, by Orion IP, LLC. The suit alleges that we, and the other 63 defendants, infringe two patents owned by Orion that relate to the making and using supply chain methods, sales methods, sales systems, marketing methods, marketing systems, and inventory systems. On April 30, 2007, we filed an answer denying Orion s allegations and a counterclaim asserting that Orion s patent is invalid. The case is in its initial stages. As we have consistently done with similar suits filed by patent trolls, we intend to vigorously defend this action.

## ITEM 1A. RISK FACTORS

*These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially. For a detailed discussion of these risks and uncertainties please see Item 1A Risk Factors and the description of risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2006. 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.*

### Risks Relating to Overstock

**We have a history of significant losses. If we do not achieve profitability, our financial condition and our stock price could suffer.**

We have a history of losses and we may continue to incur operating and net losses for the foreseeable future. We incurred net loss of $21.4 million for the three months ended March 31, 2007. As of December 31, 2006 and March 31, 2007, our accumulated deficit was $198.7 million and $220.1 million, respectively. We will need to generate significant revenues to achieve profitability, and we may not be able to do so. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. If our revenues grow more slowly than we anticipate, or if our operating expenses exceed our expectations, our financial results would be harmed.

We will continue to incur significant operating expenses and capital expenditures as we:

- enhance our distribution and order fulfillment capabilities;
- further improve our order processing systems and capabilities;
- develop enhanced technologies and features;
- expand our customer service capabilities to better serve our customers needs;
- expand or modify our product offerings;
- rent or terminate warehouse and office space;
- increase our general and administrative functions to support our operations; and
- maintain or increase our sales, branding and marketing activities, including maintaining existing or entering into new online marketing arrangements, and continuing or increasing our national television and radio branding campaigns.

Because we will incur many of these expenses before we receive any revenues from our efforts, our losses may be greater than the losses we would incur if we developed our business more slowly. Further, we base our expenses in large part on our operating plans and future revenue projections. Many of our expenses are fixed in the short term, and we may not be able to quickly reduce spending if our revenues are lower than we project. Therefore, any significant shortfall in revenues would likely harm our business, prospects, operating results and financial condition. In addition, we may find that these efforts are more expensive than we currently anticipate which would further increase our losses. Also, the timing of these expenses may contribute to fluctuations in our quarterly operating results.

**If we fail to accurately forecast our expenses and revenues, our business, operating results and financial condition may suffer and the price of our securities may decline.**

Our limited operating history and the rapidly evolving nature of our industry make forecasting operating results difficult.

We have recently completed several large, complex and expensive infrastructure upgrades in order to increase our ability to handle larger volumes of sales and to develop or increase our ability to perform a variety of analytical procedures relating to our business, and we are continuing the work to upgrade and further expand these and other components of our infrastructure. We have experienced difficulties with the implementation of various aspects to the upgrades of our infrastructure, and have incurred increased expenses as a result of these difficulties. As a result of these expenditures, our ability to quickly reduce spending if our revenues are lower than we project is limited. Therefore, any significant shortfall in the revenues for which we have built and are continuing to build our infrastructure would likely harm our business, prospects, operating results and financial condition and cause our results of operation to fall below the expectations of public market analysts and investors. If this occurs, the price of our securities may decline.

**We depend on our relationships with third party fulfillment partners for a large portion of the products that we offer for sale on our Websites. If we fail to maintain these relationships, our business will suffer.**

At March 31, 2007, we had fulfillment partner relationships with approximately 485 third parties whose products we offer for sale on our Websites. These products accounted for approximately 72% of the non-BMMG products available. We do not have any long-term agreements with any of these third parties. Our agreements with third parties are terminable at will by either party immediately upon notice. In general, we agree to offer the third parties products on our Websites and these third parties agree to provide us with information about their products, honor our customer service policies and ship the products directly to the customer. If we do not maintain our existing or build new relationships with third parties on acceptable commercial terms, we may not be able to offer a broad selection of merchandise, and customers may refuse to shop at our Websites. In addition, manufacturers may decide not to offer particular products for sale on the Internet. If we are unable to maintain our existing or build new fulfillment partner relationships or if other product manufacturers refuse to allow their products to be sold via the Internet, our business and prospects would suffer severely.

**We are partially dependent on third parties to fulfill a number of our fulfillment, distribution and other retail functions. If such parties are unwilling or unable to continue providing these services, our business could be seriously harmed.**

In our fulfillment partner business, although we handle returned merchandise, we continue to rely on third parties to conduct a number of other traditional retail operations with respect to their respective products that we offer for sale on our Websites, including maintaining inventory, preparing merchandise for shipment to individual customers and timely distribution of purchased merchandise. We have no effective means to ensure that these third parties will continue to perform these services to our satisfaction or on commercially reasonable terms. In addition, because we do not take possession of these third parties products, we are unable to fulfill these traditional retail operations ourselves. Our customers could become dissatisfied and cancel their orders or decline to make future purchases if these third parties are unable to deliver products on a timely basis. If our customers become dissatisfied with the services provided by these third parties, our reputation and the Overstock.com brand could suffer.

**We rely on our relationships with manufacturers, retailers and other suppliers to obtain sufficient quantities of quality merchandise on acceptable terms. If we fail to maintain our supplier relationships on acceptable terms, our sales and profitability could suffer.**

To date, we have not entered into contracts with manufacturers or liquidation wholesalers that guarantee the availability of merchandise for a set duration. Our contracts or arrangements with suppliers do not provide for the continuation of particular pricing practices and may be terminated by either party at any time. Our current suppliers may not continue to sell their excess inventory to us on current terms or at all, and we may not be able to establish new supply relationships. For example, it is difficult for us to maintain high levels of product quality and selection because none of the manufacturers, suppliers and liquidation wholesalers from whom we purchase products on a purchase order by purchase order basis have a continuing obligation to provide us with merchandise at historical levels or at all. In most cases, our relationships with our suppliers do not restrict the suppliers from selling their respective excess inventory to other traditional or online merchandise liquidators, which could in turn limit the selection of products available on our Websites. If we are unable to develop and maintain relationships with suppliers that will allow us to obtain sufficient quantities of merchandise on acceptable commercial terms, such inability could harm our business, prospects, results of operation and financial condition.

**We depend upon third-party delivery services to deliver our products to our customers on a timely and consistent basis. Deterioration in our relationship with any one of these third parties could decrease our ability to track shipments, cause shipment delays, and increase our shipping costs and the number of damaged products.**

We rely upon multiple third parties for the shipment of our products. We cannot be sure that these relationships will continue on terms favorable to us, if at all. Unexpected increases in shipping costs or delivery times, particularly during the holiday season, could harm our business, prospects, financial condition and results of operations. If our relationships with these third parties are terminated or impaired or if these third parties are unable to deliver products for us, whether through labor shortage, slow down or stoppage, deteriorating financial or business condition, responses to terrorist attacks or for any other reason, we would be required to use alternative carriers for the shipment of products to our customers. In addition, conditions such as adverse weather can prevent any carriers from performing their delivery services, which can have an adverse effect on our customers satisfaction with us. In any of these circumstances, we may be unable to engage alternative carriers on a timely basis, upon terms favorable to us, or at all. Changing carriers would likely have a negative effect on our business, prospects, operating results and financial condition. Potential adverse consequences include:

- reduced visibility of order status and package tracking;
- delays in order processing and product delivery;
- increased cost of delivery, resulting in reduced gross margins; and
- reduced shipment quality, which may result in damaged products and customer dissatisfaction.

**A significant number of merchandise returns could harm our business, financial condition and results of operations.**

We allow our customers to return products and, beginning July 1, 2003, we started accepting returns of products sold through our fulfillment partners. We modify our policies relating to returns from time to time, and any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer return customers. If merchandise returns are significant, our business, prospects, financial condition and results of operations could be harmed.

**If the products that we offer on our Websites do not reflect our customers tastes and preferences, our sales and profit margins would decrease.**

Our success depends in part on our ability to offer products that reflect consumers tastes and preferences. Consumers tastes are subject to frequent, significant and sometimes unpredictable changes. Because the products that we sell typically consist of manufacturers and retailers excess inventory, we have limited control over the specific products that we are able to offer for sale. If our merchandise fails to satisfy customers tastes or respond to changes in customer preferences, our sales could suffer and we could be required to mark down unsold inventory which would depress our profit margins. In addition, any failure to offer products in line with customers preferences could allow our competitors to gain market share. This could have an adverse effect on our business, prospects, results of operations and financial condition.

**We face risks relating to our inventory.**

We directly purchase some of the merchandise that we sell on our Websites. We assume the inventory damage, theft and obsolescence risks, as well as price erosion risks for products that we purchase directly. These risks are especially significant because some of the merchandise we sell on our Websites are characterized by rapid technological change, obsolescence and price erosion (for example, computer hardware, software and consumer electronics), and because we sometimes make large purchases of particular types of inventory. In addition, we often do not receive warranties on the merchandise we purchase. Further, beginning July 1, 2003, we started accepting returns of products sold through our fulfillment partners, and we have the risk of reselling the returned products.

In the recent past, we have recorded charges for obsolete inventory and have had to sell certain merchandise at a discount or loss. It is impossible to determine with certainty whether an item will sell for more than the price we pay for it. To the extent that we rely on purchased inventory, our success will depend on our ability to liquidate our inventory rapidly, the ability of our buying staff to purchase inventory at attractive prices relative to its resale value and our ability to manage customer returns and the shrinkage resulting from theft, loss and misrecording of inventory. If we are unsuccessful in any of these areas, we may be forced to sell our inventory at a discount or loss.

**Historically, we have grown quickly and if we fail to manage our growth, our business will suffer.**

Historically, we have rapidly and significantly expanded our operations, and anticipate that further significant expansion will be required to address potential growth in our customer base and market opportunities. This expansion has placed, and is expected to continue to place, a significant strain on our management, operational and financial resources. Some of our officers have no prior senior management experience at public companies. Our new employees include a number of key managerial, technical and operations personnel, and we expect to add additional key personnel in the future. To manage the expected growth of our operations and personnel, we will be required to improve existing and implement new transaction-processing, operational and financial systems, procedures and controls, and to expand, train and manage our already growing employee base. If we are unable to manage growth effectively, our business, prospects, financial condition and results of operations will be harmed.

**The loss of key personnel or any inability to attract and retain additional personnel could affect our ability to successfully grow our business.**

Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel, including Patrick M. Byrne, our Chief Executive Officer, and Jason C. Lindsey, our President and Chief Operating Officer. Our performance also depends on our ability to retain and motivate other officers and key employees. The loss of the services of any of our executive officers or other key employees for any unforeseen reason, including without limitation, illness or call to military service, could harm our business, prospects, financial condition and results of operations. We do not have employment agreements with any of our key personnel and we do not maintain key person life insurance policies. Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly-skilled technical, managerial, editorial, merchandising, marketing and customer service personnel. Competition for such personnel is intense, and we cannot assure you that we will be able to successfully attract, assimilate or retain sufficiently qualified personnel. Our failure to retain and attract the necessary technical, managerial, editorial, merchandising, marketing and customer service personnel could harm our revenues, business, prospects, financial condition and results of operations.

**We have a rapidly evolving business model.**

Our business model has evolved and continues to do so. In the past we have added additional types of services and product offerings, and in some cases we have modified or discontinued those offerings. We may continue to try to offer additional types of products or services, and we cannot offer any assurance that any of them will be successful. From time to time we have also modified aspects of our business model relating to our product mix and the mix of direct/fulfillment partner sourcing of the products we offer. We may continue to modify this aspect of our business as well as other significant aspects of our business. We cannot offer any assurance that these or any other modifications will be successful.

**We may be unable to manage expansion into new business areas which could harm our business operations and reputation.**

Our long-term strategic plan involves expansion of our operations to offer additional types of products and services. We cannot assure you that our efforts to expand our business in this manner will succeed. Because we were unable to generate significant traffic for our former B2B site, in the third quarter of 2004, we merged the B2B site into our main website, and opened our Wholesale bulk purchase program. We have also attempted to expand into other areas, such as the Other Frontiers listed under the Other Stores link, and the results of these expansion efforts have not yet met our expectations. Our failure to succeed in these markets or businesses or in other product or service offerings may harm our business, prospects, financial condition and results of operation. We cannot assure you that we will be able to expand our operations in a cost-effective or timely manner or that our efforts to expand will be successful. Furthermore, any new business or Website we launch that is not favorably received by consumers could damage our reputation or the Overstock.com brand. We may expand the number of categories of products we carry on our Websites and these and any other expansions of our operations would also require significant additional expenses and development and would strain our management, financial and operational resources. The lack of market acceptance of such efforts or our inability to generate satisfactory revenues from such expanded services or products to offset their cost could harm our business, prospects, financial condition and results of operations.

**We may expand our international business, causing our business to become increasingly susceptible to numerous international business risks and challenges that could affect our profitability.**

We have begun to expand into international markets, and in the future we may do so more aggressively. International sales and transactions are subject to inherent risks and challenges that could adversely affect our profitability, including:

- the need to develop new supplier and manufacturer relationships;
- the need to comply with additional laws and regulations to the extent applicable;

- unexpected changes in international regulatory requirements and tariffs;
- difficulties in staffing and managing foreign operations;
- longer payment cycles from credit card companies;
- greater difficulty in accounts receivable collection;
- potential adverse tax consequences;
- price controls or other restrictions on foreign currency; and
- difficulties in obtaining export and import licenses.

To the extent we generate international sales and transactions in the future, any negative impact on our international operations could negatively impact our business. In particular, gains and losses on the conversion of foreign payments into United States dollars may contribute to fluctuations in our results of operations and fluctuating exchange rates could cause reduced gross revenues and/or gross margins from non-dollar-denominated international sales.

**In order to obtain future revenue growth and achieve and sustain profitability we will have to attract and retain customers on cost-effective terms.**

Our success depends on our ability to attract and retain customers on cost-effective terms. We have relationships with online services, search engines, directories and other Websites and e-commerce businesses to provide content, advertising banners and other links that direct customers to our Websites. We rely on these relationships as significant sources of traffic to our Websites and to generate new customers. If we are unable to develop or maintain these relationships on acceptable terms, our ability to attract new customers and our financial condition could be harmed. In addition, certain of our online marketing agreements may require us to pay upfront fees and make other payments prior to the realization of the sales, if any, associated with those payments. Accordingly, if these agreements or similar agreements that we may enter into in the future fail to produce the sales that we anticipate, our results of operations will be adversely affected. We cannot assure you that we will be able to increase our revenues, if at all, in a cost-effective manner. We periodically conduct national television and radio branding and advertising campaigns. Such campaigns are expensive and may not result in the cost effective acquisition of customers.

Further, many of the parties with which we may have online-advertising arrangements could provide advertising services for other online or traditional retailers and merchandise liquidators. As a result, these parties may be reluctant to enter into or maintain relationships with us. Failure to achieve sufficient traffic or generate sufficient revenue from purchases originating from third parties may result in termination of these relationships by these third parties. Without these relationships, our revenues, business, prospects, financial condition and results of operations could suffer.

**We may not be able to compete successfully against existing or future competitors.**

The online liquidation services market is rapidly evolving and intensely competitive. Barriers to entry are minimal, and current and new competitors can launch new Websites at a relatively low cost. Our consumer Website currently competes with:

- liquidation e-tailers such as SmartBargains;
- online retailers with discount departments such as Amazon.com, Inc., eBay, Inc. and Buy.com, Inc.; and
- traditional retailers and liquidators such as Ross Stores, Inc., Walmart Stores, Inc., TJX Companies, Inc., Costco Wholesale Corporation, Target Corporation and Best Buy Co., Inc., which may or may not also have an online presence.

**Our Website competes with liquidation brokers and retailers and online marketplaces such as eBay, Inc.**

We expect the online liquidation services market to become even more competitive as traditional liquidators and online retailers continue to develop services that compete with our services. In addition, manufacturers and retailers may decide to create their own Websites to sell their own excess inventory and the excess inventory of third parties. Competitive pressures created by any one of our competitors, or by our competitors collectively, could harm our business, prospects, financial condition and results of operations.

Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service or marketing decisions or acquisitions that could harm our business, prospects, financial condition and results of operations. For example, to the extent that we enter new lines of businesses such as third-party logistics, or discount brick and mortar retail, we would be competing with large established businesses such as APL Logistics, and Ltd., Ross Stores, Inc., respectively. We have recently entered the online auctions and car listing businesses in which we compete with large established businesses including eBay, Inc. and AutoTrader.com, Inc.

Many of our current and potential competitors described above have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. In addition, online retailers and liquidation e-tailers may be acquired by, receive investments from or enter into other commercial relationships with larger, well-established and well-financed companies. Some of our competitors may be able to secure merchandise from manufacturers on more favorable terms, devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing or inventory availability policies and devote substantially more resources to Website and systems development than we do. Increased competition may result in reduced operating margins, loss of market share and a diminished brand franchise. We cannot assure you that we will be able to compete successfully against current and future competitors.

**Our operating results depend on our Websites, network infrastructure and transaction-processing systems. Capacity constraints or system failures would harm our business, prospects, results of operations and financial condition.**

Any system interruptions that result in the unavailability of our Websites or reduced performance of our transaction systems would reduce our transaction volume and the attractiveness of the services that we provide to suppliers and third parties and would harm our business, prospects, operating results and financial condition.

We use internally developed systems for our Websites and certain aspects of transaction processing, including customer profiling and order verifications. We have experienced periodic systems interruptions due to server failure, which we believe will continue to occur from time to time. If the volume of traffic on our Websites or the number of purchases made by customers substantially increases, we will need to further expand and upgrade our technology, transaction processing systems and network infrastructure. We have experienced and expect to continue to experience temporary capacity constraints due to sharply increased traffic during sales or other promotions and during the holiday shopping season. Capacity constraints can cause unanticipated system disruptions, slower response times, and degradation in levels of customer service, impaired quality and delays in reporting accurate financial information.

Our transaction processing systems and network infrastructure may be unable to accommodate increases in traffic in the future. We may be unable to project accurately the rate or timing of traffic increases or successfully upgrade our systems and infrastructure to accommodate future traffic levels on our Websites. In addition, we may be unable to upgrade and expand our transaction processing systems in an effective and timely manner or to integrate any newly developed or purchased functionality with our existing systems. For example, in the third quarter 2005 we experienced difficulties with our implementation of infrastructure upgrades, which resulted in our inability to upload new products to our website for a period of approximately five weeks. Any such difficulties with our transaction processing systems or other difficulties upgrading, expanding or integrating various aspects of our systems may cause unanticipated system disruptions, slower response times, and degradation in levels of customer service, additional expense, impaired quality and speed of order fulfillment or delays in reporting accurate financial information.

**If the facilities where substantially all of our computer and communications hardware is located fail, our business, results of operations and financial condition will be harmed.**

Our success, and, in particular, our ability to successfully receive and fulfill orders and provide high-quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications systems. Substantially all of our computer and communications hardware is located at a single co-location facility in Salt Lake City, Utah, with a partially redundant back-up system located at our corporate headquarters in Salt Lake City. Although we have designed our back-up system in an effort to avoid or minimize service interruptions in the event of a failure of our main facility, our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, acts of war, break-ins, earthquake and similar events. We do not have a formal disaster recovery plan and our business interruption insurance may be insufficient to compensate us for losses that may occur. Despite the implementation of network security measures, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of critical data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could harm our business, prospects, financial condition and results of operations.

**We may be unable to protect our proprietary technology or keep up with that of our competitors.**

Our success depends to a significant degree upon the protection of our software and other proprietary intellectual property rights. We may be unable to deter misappropriation of our proprietary information, detect unauthorized use and take appropriate steps to enforce our intellectual property rights. In addition, our competitors could, without violating our proprietary rights, develop technologies that are as good as or better than our technology.

Our failure to protect our software and other proprietary intellectual property rights or to develop technologies that are as good as our competitors could put us at a disadvantage to our competitors. In addition, the failure of the third parties whose products we offer for sale on our Websites to protect their intellectual property rights, including their domain names, could impair our operations. These failures could harm our business, results of operations and financial condition.

**If we do not respond to rapid technological changes, our services could become obsolete and we could lose customers.**

To remain competitive, we must continue to enhance and improve the functionality and features of our e-commerce businesses. We may face material delays in introducing new services, products and enhancements. If this happens, our customers may forgo the use of our Websites and use those of our competitors. The Internet and the online commerce industry are rapidly changing. If competitors introduce new products and services using new technologies or if new industry standards and practices emerge, our existing Websites and our proprietary technology and systems may become obsolete. Our failure to respond to technological change or to adequately maintain, upgrade and develop our computer network and the systems used to process customers orders and payments could harm our business, prospects, financial condition and results of operations.

**We may not be able to obtain trademark protection for our marks, which could impede our efforts to build brand identity.**

We have filed trademark applications with the Patent and Trademark Office seeking registration of certain service marks and trademarks. There can be no assurance that our applications will be successful or that we will be able to secure significant protection for our service marks or trademarks in the United States or elsewhere as we expand internationally. Our competitors or others could adopt product or service marks similar to our marks, or try to prevent us from using our marks, thereby impeding our ability to build brand identity and possibly leading to customer confusion. Any claim by another party against us or customer confusion related to our trademarks, or our failure to obtain trademark registration, could negatively affect our business.

**We may not be able to enforce protection of our intellectual property rights under the laws of other countries.**

As we continue to expand internationally, we are subject to risks of doing business internationally as related to our intellectual property, including:

- legal uncertainty regarding liability for the listings and other content provided by our users, including uncertainty as a result of less Internet-friendly legal systems, unique local laws, and lack of clear precedent or applicable law; and

- differing intellectual property laws, which may provide insufficient protection for our intellectual property.

**Our business and reputation may be harmed by the listing or sale of pirated, counterfeit or illegal items by third parties, and by intellectual property litigation.**

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our Websites infringe third-party copyrights, trademarks and trade names or other intellectual property rights or that we have otherwise infringed third parties past, current or future intellectual property rights.

We may be unable to prevent third parties from listing unlawful goods, and we may be subject to allegations of civil or criminal liability for unlawful activities carried out by third parties through our Websites. In the future, we may implement measures to protect against these potential liabilities that could require us to spend substantial resources and/or to reduce revenues by discontinuing certain service offerings. Any costs incurred as a result of liability or asserted liability relating to the sale of unlawful goods or the unlawful sale of goods could harm our revenues, business, prospects, financial condition and results of operations.

Resolving litigation or claims regarding patents or other intellectual property, whether meritorious or not, could be costly, time-consuming, cause service delays, divert our management and key personnel from our business operations, require expensive or unwanted changes in our methods of doing business or require us to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

Negative publicity generated as a result of the foregoing could damage our reputation, harm our business and diminish the value of our brand name.

**Gradient Analytics and Rocker Partners, L.P. Litigation**

In August 2005 we filed an unfair business practice lawsuit against Gradient Analytics, Rocker Partners, L.P. and others, alleging that the defendants have conspired to denigrate Overstock s business for personal profit. In October 2005 we filed an amended complaint alleging additional causes of action and articulating in greater detail the allegations against the defendants. Overstock s Chief Executive Officer, Dr. Patrick Byrne, has appeared on nationally syndicated television programs and elsewhere to discuss the litigation. The use of management s time and attention in connection with the litigation and related matters may reduce the time management is able to spend on other aspects of our business, which may have adverse effects on other aspects of our business. To the extent that any such adverse effects exceed any benefits we may realize from pursuing the litigation, our business, prospects, financial condition and results of operation may suffer.

**Prime Broker Litigation**

In February 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. The use of management s time and attention in connection with the litigation and related matters may reduce the time management is able to spend on other aspects of our business, which may have adverse effects on other aspects of our business. To the extent that any such adverse effects exceed any benefits we may realize from pursuing the litigation, our business, prospects, financial condition and results of operation may suffer.

**We may be liable if third parties misappropriate our customers personal information.**

If third parties are able to penetrate our network security or otherwise misappropriate our customers personal information or credit card information, or if we give third parties improper access to our customers personal information or credit card information, we could be subject to liability. This liability could include claims for unauthorized purchases with credit card information, impersonation or other similar fraud claims. This liability could also include claims for other misuses of personal information, including unauthorized marketing purposes. These claims could result in litigation. Liability for misappropriation of this information could adversely affect our business. In addition, the Federal Trade Commission and state agencies have been investigating various Internet companies regarding their use of personal information. We could incur additional expenses if new regulations regarding the use of personal information are introduced or if government agencies investigate our privacy practices.

We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of confidential information such as customer credit card numbers. We cannot assure you that advances in computer capabilities, new discoveries in the field of cryptography or other events or developments will not result in a compromise or breach of the algorithms that we use to protect customer transaction data. If any such compromise of our security were to occur, it could harm our reputation, business, prospects, financial condition and results of operations. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. We cannot assure you that our security measures will prevent security breaches or that failure to prevent such security breaches will not harm our business, prospects, financial condition and results of operations.

**We may be subject to product liability claims that could be costly and time consuming.**

We sell products manufactured for us by third parties, some of which may be defective. If any product that we sell were to cause physical injury or injury to property, the injured party or parties could bring claims against us as the manufacturer and/or retailer of the product. Our insurance coverage may not be adequate to cover every claim that could be asserted. If a successful claim were brought against us in excess of our insurance coverage, it could adversely affect our business. Even unsuccessful claims could result in the expenditure of funds and management time and could have a negative impact on our business.

**The promissory notes we hold in connection with the sale of our travel business are risky.**

As part of the sale of our travel business, we now hold senior and junior promissory notes issued by the purchaser. Both of these notes have a stated amount of $3,000,000. The security on the senior note is the stock of the travel company we sold. There is no security on the junior note, which note also may be subordinated to all other debt of the travel company, and, according to the junior note terms, is not in default so long as the senior debt is outstanding. In the event of default on one or both of these notes, it is possible that stock held as security on the note will have lost some or all of its value. If the purchaser defaults on one or the other of these notes, and the company is unable collect or realize comparable value by foreclosing on the stock held as security, it could adversely affect our business.

**We have significant indebtedness.**

In connection with our sale of our 3.75% Convertible Senior Notes (the Senior Notes ) in November 2004, we incurred $120.0 million of indebtedness, due December 1, 2011. Under the repurchase program approved by our Board of Directors in 2005, we retired $33.0 million and $10.0 million of the Senior Notes in June and November 2005 for $27.9 million and $7.8 million in cash, respectively. As a result of the note retirements, we recognized a gain of $6.2 million for the year ended December 31, 2005, net of the associated unamortized discount of $1.2 million. As of March 31, 2007, $77.0 million of the Senior Notes remained outstanding. As a result of this indebtedness, our principal and interest payment obligations increased substantially. The degree to which we are leveraged could materially and adversely affect our ability to obtain additional financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations is dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

**We may be unable to generate sufficient cash flow to satisfy our debt service obligations.**

Our ability to generate cash flow from operations to make interest payments on our debt obligations will depend on our future performance, which will be affected by a range of economic, competitive and business factors. We cannot control many of these factors, including general economic conditions and the health of the internet retail industry. If our operations do not generate sufficient cash flow from operations to satisfy our debt service obligations, we may need to borrow additional funds to make these payments or undertake alternative financing plans, such as refinancing or restructuring our debt, or reducing or delaying capital investments and acquisitions. Additional funds or alternative financing may not be available to us on favorable terms, or at all. Our inability to generate sufficient cash flow from operations or obtain additional funds or alternative financing on acceptable terms could have a material adverse effect on our business, prospects, financial condition and results of operations.

**Risks Relating to our Auctions Site Business**

**Our auctions site is a new business.**

Our auctions site began operation in September 2004. The online auctions business is a new business for us, and we cannot ensure that our expansion into the online auctions business will succeed. Our entry into the online auctions business will require us to devote substantial financial, technical, managerial and other resources to the business. It will also expose us to additional risks, including legal and regulatory risks, and it will require us to compete with established businesses having substantially greater experience in the online auctions business and substantially greater resources than we have.

**Our auction business may be subject to a variety of regulatory requirements.**

Many states and other jurisdictions, including Utah, where our company is located, have regulations governing the conduct of traditional auctions and the liability of traditional auctioneers in conducting auctions. Although the vast majority of these regulations clearly contemplated only traditional auctions, not online auctions, the potential application of these types of regulations to online auction sites is not clear. We are aware that several states and some foreign jurisdictions have attempted to impose such regulations on other companies operating online auction sites or on the users of those sites. In addition, certain states have laws or regulations that do expressly apply to online auction site services. Although we do not expect these laws to have a significant effect on our auction site business, we will incur costs in complying with these laws, and we may from time to time be required to make changes in our business that may increase our costs, reduce our revenues, cause us to prohibit the listing of certain items in certain locations, or make other changes that may adversely affect our auctions business.

**Current and future laws could affect our auctions business.**

Like our shopping site business, our auction site business is subject to the same laws and regulations that apply to other companies conducting business on and off the Internet. In addition, our auction site business may be affected by other laws and regulations, such as those that expressly apply to online auction site services. Further, because of the wide range of items that users of our auctions service may choose to list on the site, a variety of additional laws and regulations may apply to transactions between users of our site, such as those requiring a license to sell or purchase certain items or mandating particular disclosures in connection with an offer or sale of an item. To the extent that such current or future laws or regulations prevent users from selling items on our auction site, they could harm our business.

**Our business may be harmed if our auction site is used for unlawful transactions.**

The law regarding the potential liability of an online auction service for the activities of its users is not clear. We prohibit the listing of numerous categories of items in an effort to reduce the possibility that users of our auction site will engage in an unlawful transaction. However, we cannot assure that users of the site will comply with all laws and regulations applicable to them and their transactions, and we may be subject to allegations of civil or criminal liability for any unlawful activities conducted by them. Any costs we incur as a result of any such allegations, or as a result of actual or alleged unlawful transactions utilizing our site, or in our efforts to prevent any such transactions, may harm our business. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

**Fraudulent activities using our auctions site and disputes between users of our auctions site may harm our business.**

We are aware that other companies operating online auction services have periodically received complaints from users alleging that they have not received the purchase price or the goods they expected to receive, and that in some cases users have been arrested and convicted for engaging in fraudulent activities using those companies auction sites. We may receive similar complaints. We do not have the ability to require users of our services to fulfill their obligations to make payments or to deliver items. We are aware that other companies periodically receive complaints from buyers about the quality of the items they purchase, requests for reimbursement of amounts paid, and communications threatening or commencing legal actions against them. We may receive similar complaints, requests and communications in connection with our auctions site business.

**We are subject to risks associated with information transmitted through our service.**

The law relating to the liability of online services companies for information carried on or disseminated through their services is currently unsettled. Claims could be made against online services companies under both U.S. and foreign law for defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their services. We are aware that private lawsuits seeking to impose liability under a number of these theories have been brought against other companies operating auction sites. In addition, domestic and foreign legislation has been proposed that would prohibit or impose liability for the transmission over the Internet of certain types of information. Our service permits users to make comments regarding other users. Although all such comments are generated by users and not by us, we are aware that claims of defamation or other injury have been made against other companies operating auction services in the past and could be made in the future against us for comments made by users. Recent court decisions have narrowed the scope of the immunity provided to Internet service providers like us under the Communications Decency Act. This trend, if continued, may increase our potential liability to third parties for the user-provided content on our site.

**Difficulties or negative publicity associated with our auctions business could affect our main shopping site business.**

Any significant operational or other difficulties we encounter with our auctions business could damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally. Negative publicity resulting from actual or alleged fraudulent or deceptive conduct by users of our auctions site could also damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

**Risks Relating to our Cars Site Business**

**Our cars site is a new business.**

Our cars site began operation in December 2006. The cars site is a listing service for automobile sellers. The online car listing service is a new business for us. We cannot ensure that our expansion into the car listing business will succeed. Our entry into this business will require us to devote substantial financial, technical, managerial and other resources to the business. It will also expose us to additional risks, including legal and regulatory risks, and it will require us to compete with established businesses having substantially greater experience in the online car listing service business and substantially greater resources than we have.

**Our car listing business may be subject to a variety of regulatory requirements.**

Many states and other jurisdictions, including Utah, where we are located, have regulations governing the conduct of car sellers and public advertisement for car sales. Generally, these regulations govern the conduct of those sellers advertising their automobiles for sale and are not directly applicable to those providing the medium through which the advertisement is made available to the public. Sellers are often subject to regulations in the nature of truth in advertising laws. The application of these regulations to online car listing service providers is not clear. Although we do not expect these laws to have a significant effect on our car listing business, we will incur costs in researching and complying with these laws, and we may from time to time be required to make changes in our business that may increase our costs, reduce our revenues, cause us to prohibit certain listing or advertising practices, or make other changes that may adversely affect our cars listing business.

**Current and future laws could affect our car listing business.**

Like our shopping site business, our car listing business is subject to the same laws and regulations that apply to other companies conducting business on and off the Internet. In addition, our car listing site business may be affected by other laws and regulations, such as those that expressly apply to advertising automobiles for sale. To the extent that such current or future laws or regulations prevent users from selling items on our car listing site, they could harm our business.

**Our business may be harmed if our car listing site is used for unlawful transactions.**

The law regarding the potential liability of an online listing service for automobile sales is not clear. The platform of the listing service will be accessible to those subscribers who will have the ability to feature their cars for sale and will supply the text descriptions of the vehicles, including the general condition of the vehicle and other important information. We will have no ability beforehand to know if the information sellers provide is correct. While our site terms and conditions of usage will prohibit unlawful acts, we cannot rule out the possibility that users of our cars listing site will engage in an unlawful transactions, or fail to comply with all laws and regulations applicable to them and their transactions, and we may be subject to allegations of civil or criminal liability for any unlawful activities conducted by them. Any costs we incur as a result of any such allegations, or as a result of actual or alleged unlawful transactions utilizing our site, or in our efforts to prevent any such transactions, may harm our business. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

**Fraudulent activities using our cars listing site and disputes between users of our car listing site may harm our business.**

We are aware that other companies operating online car listing services have periodically received complaints from users alleging improprieties in connection with listings, and occasionally these complaints may result in regulatory action. Particularly, with any online listing service there is the possibility that sellers may attempt to employ bait and switch techniques, attracting consumers with advertisements of low cost, good condition vehicles in hopes of switching buyer interest to another less favorable vehicle once a potential purchaser responds. Additionally, sellers may attempt to sell vehicles without accurate descriptions of the condition of the vehicles. We do not have the ability to require users of our services to fulfill their obligations to make accurate disclosures or comply with consumer laws prohibiting bait and switch or other prohibited seller tactics. We are aware that other companies providing similar services periodically receive complaints from vehicle purchasers about the quality of the vehicles they purchase, requesting reimbursement of amounts they have paid, threatening or commencing legal actions against the listing service for damages. We may receive similar complaints, requests and communications, and encounter similar legal actions in connection with our cars listing business, which may harm our business or reputation among consumers.

**Risks Relating to the Internet Industry**

**Our success is tied to the continued use of the Internet and the adequacy of the Internet infrastructure.**

Our future revenues and profits, if any, substantially depend upon the continued widespread use of the Internet as an effective medium of business and communication. Factors which could reduce the widespread use of the Internet include:

- actual or perceived lack of security of information or privacy protection;
- possible disruptions, computer viruses or other damage to the Internet servers or to users computers; and
- governmental regulation.

**Customers may be unwilling to use the Internet to purchase goods.**

Our long-term future depends heavily upon the general public s willingness to use the Internet as a means to purchase goods. E-commerce remains a relatively new concept, and large numbers of customers may not begin or continue to use the Internet to purchase goods. The demand for and acceptance of products sold over the Internet are highly uncertain, and most e-commerce businesses have a short track record. If consumers are unwilling to use the Internet to conduct business, our business may not develop profitably.

**The security risks or perception of risks of e-commerce may discourage customers from purchasing goods from us.**

In order for the e-commerce market to develop successfully, we and other market participants must be able to transmit confidential information securely over public networks. Third parties may have the technology or know-how to breach the security of customer transaction data. Any breach could cause customers to lose confidence in the security of our Websites and choose not to purchase from our Websites. If someone is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt our operations. Concerns about the security and privacy of transactions over the Internet could inhibit the growth of the Internet and e-commerce. Our security measures may not effectively prohibit others from obtaining improper access to our information. Third parties may target our customers directly with fraudulent identity theft schemes designed to appear as legitimate communications from us. Any security breach or fraud perpetrated on our customers could expose us to increased costs and to risks of loss, litigation and liability and could seriously disrupt our operations.

**Credit card fraud could adversely affect our business.**

We do not carry insurance against the risk of credit card fraud, so the failure to adequately control fraudulent credit card transactions could reduce our net revenues and our gross margin. We have implemented technology to help us detect the fraudulent use of credit card information. However, we may in the future suffer losses as a result of orders placed with fraudulent credit card data even though the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions because we do not obtain a cardholder s signature. If we are unable to detect or control credit card fraud, our liability for these transactions could harm our business, results of operation or financial condition.

**If one or more states successfully assert that we should collect sales or other taxes on the sale of our merchandise or the merchandise of third parties that we offer for sale on our Websites, our business could be harmed.**

We do not currently collect sales or other similar taxes for physical shipments of goods into states other than Utah and Indiana. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us and other out-of-state companies that engage in online commerce. Our business could be adversely affected if one or more states or any foreign country successfully asserts that we should collect sales or other taxes on the sale of our merchandise.

**Existing or future government regulation could harm our business.**

We are subject to the same federal, state and local laws as other companies conducting business on the Internet. Today there are relatively few laws specifically directed towards conducting business on the Internet. However, due to the increasing popularity and use of the Internet, many laws and regulations relating to the Internet are being debated at the state and federal levels. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, quality of products and services, taxation, advertising, intellectual property rights and information security. Applicability to the Internet of existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy could also harm our business. For example, United States and foreign laws regulate our ability to use customer information and to develop, buy and sell mailing lists. The vast majority of these laws was adopted prior to the advent of the Internet, and do not contemplate or address the unique issues raised thereby. Those laws that do reference the Internet are only beginning to be interpreted by the courts and their applicability and reach are therefore uncertain. These current and future laws and regulations could harm our business, results of operation and financial condition.

**Laws or regulations relating to privacy and data protection may adversely affect the growth of our Internet business or our marketing efforts.**

We are subject to increasing regulation at the federal, state and international levels relating to privacy and the use of personal user information. For example, we are subject to various telemarketing laws that regulate the manner in which we may solicit future suppliers and customers. Such regulations, along with increased governmental or private enforcement, may increase the cost of growing our business. In addition, many jurisdictions have laws that limit the uses of personal user information gathered online or offline or require companies to establish privacy policies. The Federal Trade Commission has adopted regulations regarding the collection and use of personal identifying information obtained from children under 13. Proposed legislation in this country and existing laws in foreign countries require companies to establish procedures to notify users of privacy and security policies, obtain consent from users for collection and use of personal information, and/or provide users with the ability to access, correct and delete personal information stored by us. Additional legislation regarding data security and privacy has been proposed in Congress. These data protection regulations may restrict our ability to collect demographic and personal information from users, which could be costly or harm our marketing efforts, and could require us to implement new and potentially costly processes, procedures and/or protective measures.

**Risks Relating to the Securities Markets and Ownership of Our Securities**

**The price of our securities may be volatile and you may lose all or a part of your investment.**

Our common stock has been publicly traded only since May 30, 2002. The market price of our common stock has been subject to significant fluctuations since the date of our initial public offering. These fluctuations could continue. It is possible that in some future periods our results of operations may be below the expectations of public market analysts and investors. If this occurs, the market price of our securities may decline. Among the factors that could affect the market price of our securities are as follows:

- changes in securities analysts recommendations or estimates of our financial performance or publication of research reports by analysts;
- changes in market valuations of similar companies;
- announcements by us or our competitors of significant contracts, acquisitions, commercial relationships, joint ventures or capital commitments;
- general market conditions;
- actual or anticipated fluctuations in our operating results;
- intellectual property or litigation developments;
- changes in our management team;
- economic factors unrelated to our performance; and
- our issuance of additional shares of stock or other securities.

In addition, the securities markets have experienced significant price and trading volume fluctuations. These broad market fluctuations may adversely affect the trading price of our securities. In the past, following periods of volatility in the market price of a public company s securities, securities class action litigation has often been instituted against that company. Such litigation could result in substantial cost and a diversion of management s attention and resources.

**Our quarterly operating results are volatile and may adversely affect the market price of our securities.**

Our future revenues and operating results are likely to vary significantly from quarter to quarter due to a number of factors, many of which are outside our control, and any of which could harm our business. As a result, we believe that quarterly comparisons of our operating results are not necessarily meaningful and that you should not rely on the results of one quarter as an indication of our future performance. In addition to the other risk factors described in this report, additional factors that have caused and/or could cause our quarterly operating results to fluctuate and in turn affect the market price of our securities include:

- increases in the cost of advertising;
- our inability to retain existing customers or encourage repeat purchases;
- the extent to which our existing and future marketing agreements are successful;
- price competition that results in lower profit margins or losses;
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;
- the amount and timing of our purchases of inventory;
- our inability to manage distribution operations or provide adequate levels of customer service;
- our ability to successfully integrate operations and technologies from acquisitions or other business combinations;
- entering into new lines of products;
- our ability to attract users to our new auctions and car listing sites; and
- our inability to replace the loss of significant customers.

**Our operating results may fluctuate depending on the season, and such fluctuations may affect the market price of our securities.**

We have experienced and expect to continue to experience fluctuations in our operating results because of seasonal fluctuations in traditional retail patterns. Sales in the retail and wholesale industry tend to be significantly higher in the fourth calendar quarter of each year than in the preceding three quarters due primarily to increased shopping activity during the holiday season. However, there can be no assurance that our sales in the fourth quarter will exceed those of the preceding quarters or, if the fourth quarter sales do exceed those of the preceding quarters, that we will be able to manage the increased sales effectively. Further, we generally increase our inventories substantially in anticipation of holiday season shopping activity, which has a negative effect on our cash flow. Securities analysts and investors may inaccurately estimate the effects of seasonality on our results of operations in one or more future quarters and, consequently, our operating results may fall below expectations, causing the market price of our securities to decline.

**We do not intend to pay dividends on our non-redeemable common stock, and you may lose the entire amount of your investment in our common stock.**

We have never declared or paid any cash dividends on our non-redeemable common stock and do not intend to pay dividends on our non-redeemable common stock for the foreseeable future. We intend to invest our future earnings, if any, to fund our growth. Therefore, you will not receive any funds without selling your shares. We cannot assure that you will receive a positive return on your investment when you sell your shares or that you will not lose the entire amount of your investment.

**Our Amended and Restated Certificate of Incorporation, Amended and Restated Bylaws and the Delaware General Corporation Law contain anti-takeover provisions which could discourage or prevent a takeover, even if an acquisition would be beneficial to our stockholders.**

Several provisions of our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws could discourage potential acquisition proposals and could delay or prevent a change in control of our company even if that change in control would be beneficial to our stockholders. For example, only one-third of our board of directors will be elected at each of our annual meetings of stockholders, which will make it more difficult for a potential acquirer to change the management of our company, even after acquiring a majority of the shares of our common stock. These provisions, which cannot be amended without the approval of two-thirds of our stockholders, could diminish the opportunities for a stockholder to participate in tender offers, including tender offers at a price above the then current market value of our common stock. In addition, our board of directors, without further stockholder approval, may issue preferred stock, with such terms as the board of directors may determine, that could have the effect of delaying or preventing a change in control of our company. The issuance of preferred stock could also adversely affect the voting powers of the holders of common stock, including the loss of voting control to others. We are also afforded the protections of Section 203 of the Delaware General Corporation Law, which could delay or prevent a change in control of our company or could impede a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company.

**Potential Stock Manipulation**

We have filed an unfair business practice lawsuit against Gradient Analytics, Rocker Partners, L.P. and others, alleging that the defendants have conspired to denigrate Overstock s business for personal profit, as well as an amended complaint alleging additional causes of action and articulating in greater detail the allegations against the defendants. We have also filed an unfair business practice lawsuit 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. We believe that the defendants in both of these lawsuits have engaged in unlawful actions and have caused substantial harm to Overstock, and that certain of the defendants have made efforts to drive the market price of Overstock s common stock down. To the extent that the defendants or other persons engage in any such actions or other take any other actions to interfere with or destroy or harm Overstock s existing and/or prospective business relationships with its suppliers, bankers, customers, lenders, investors, prospective investors or others, our business, prospects, financial condition and results of operation may suffer, and the price of our common stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of any such efforts.

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described above, and all other information in this Form 10-Q/A and in any reports we file with the SEC after we file this Form 10-Q/A, before deciding whether to purchase or hold our securities. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in this Form 10-Q/A could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

**Available Information**

Our Internet website address is http://www.overstock.com. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through our Internet website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our Internet website and the information contained therein or connected thereto are not a part of or incorporated into this Quarterly Report on Form 10-Q/A.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

On February 13, 2007 we gave notice of termination of a logistics services agreement with Ozburn-Hessey Logistics ( OHL ) covering our Indiana warehouse operations, which provided for usage of an additional 425,000 square feet in the same facility and other logistical services. We utilize the services of OHL to provide us with additional warehouse space and logistics services, but have determined that we do not need all of the space and services we had originally believed we would need. We estimate the termination costs of this agreement at approximately $1.4 million, payable when the agreement terminates in August 2007, which costs include prepayment of 6 months of fees under the agreement and payment of costs associated with improvement and equipment removal.

**ITEM 6. EXHIBITS**

**(a) Exhibits**

| | |
|---|---|
| 10.1 | Letter dated February 13, 2007 |
| 31 | Rule 13a-15(d)/15d-15(d) Certifications |
| 32 | Section 1350 Certifications |

**SIGNATURE**

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

OVERSTOCK.COM, INC.

/s/ David K. Chidester
David K. Chidester
Senior Vice President, Finance

Dated: March 14, 2008