# UNITED STATES SECURITIES AND EXCHANGE COMMISSION 

Washington, D.C. 20549

## FORM 10-Q

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

For the quarterly period ended June 30, 2010

Or

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

# Edgar Filing: OVERSTOCK.COM, INC - Form 10-Q <br> <br> OVERSTOCK.COM, INC. 

 <br> <br> OVERSTOCK.COM, INC.}
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

87-0634302
(I.R.S. Employer

Identification Number)

## 6350 South 3000 East

## Salt Lake City, Utah 84121

(Address, including zip code, of Registrant s principal executive offices)

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

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

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

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

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

Accelerated filer x

Smaller reporting company o

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

There were $23,060,109$ shares of the Registrant s common stock, par value $\$ 0.0001$, outstanding on July 21, 2010.

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## PART 1. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

## Overstock.com, Inc.

## Consolidated Balance Sheets

(in thousands, except per share data)

|  | $\begin{gathered} \text { June 30, } \\ 2010 \\ \text { (Unaudited) } \end{gathered}$ |  | $\begin{gathered} \text { December 31, } \\ 2009 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: |
| Assets |  |  |  |  |
| Current assets: |  |  |  |  |
| Cash and cash equivalents | \$ | 76,008 | \$ | 139,757 |
| Restricted cash |  | 2,928 |  | 4,414 |
| Accounts receivable, net |  | 8,285 |  | 11,640 |
| Inventories, net |  | 25,726 |  | 23,375 |
| Prepaid inventories, net |  | 2,718 |  | 2,879 |
| Prepaids and other assets |  | 11,805 |  | 10,275 |
| Total current assets |  | 127,470 |  | 192,340 |
| Fixed assets, net |  | 29,952 |  | 20,618 |
| Goodwill |  | 2,784 |  | 2,784 |
| Other long-term assets, net |  | 1,368 |  | 758 |
| Total assets | \$ | 161,574 | \$ | 216,500 |
| Liabilities and Stockholders Equity |  |  |  |  |
| Current liabilities: |  |  |  |  |
| Accounts payable | \$ | 40,934 | \$ | 76,623 |
| Accrued liabilities |  | 28,563 |  | 43,296 |
| Deferred revenue |  | 20,186 |  | 20,665 |
| Capital lease obligations, current |  | 701 |  | 520 |
| Total current liabilities |  | 90,384 |  | 141,104 |
| Capital lease obligations, non-current |  | 268 |  | 806 |
| Other long-term liabilities |  | 3,401 |  | 3,580 |
| Convertible senior notes, net of debt discount of \$328 and \$528 as of June 30, 2010 and |  |  |  |  |
| December 31, 2009, respectively |  | 50,347 |  | 59,466 |
| Total liabilities |  | 144,400 |  | 204,956 |
| Commitments and contingencies (Note 6) |  |  |  |  |
| Redeemable common stock, $\$ 0.0001$ par value, 65 shares outstanding as of June 30, 2010 and December 31, 2009 (Note 10) |  | 821 |  | 744 |
| Stockholders Equity: |  |  |  |  |
| Preferred stock, $\$ 0.0001$ par value, 5,000 shares authorized, no shares issued and outstanding as of June 30, 2010 and December 31, 2009 |  |  |  |  |
| Common stock, $\$ 0.0001$ par value, 100,000 shares authorized, 25,854 and 25,583 shares issued as of June 30, 2010 and December 31, 2009, respectively, and 22,991 and 22,776 shares outstanding as of June 30, 2010 and December 31, 2009, respectively Additional paid-in capital |  | 2 |  | 2 |
|  |  | 346,936 |  | 343,040 |


| Accumulated deficit | $(253,828)$ | $(256,056)$ |  |
| :--- | ---: | ---: | ---: |
| Treasury stock, 2,863 and 2,807 shares at cost as of June 30, 2010 and December 31, 2009, | $(76,757)$ | $(76,186)$ |  |
| respectively |  | 16,353 | 10,800 |
| Total stockholders equity | $\$ 161,574$ | $\$$ | 216,500 |

See accompanying notes to consolidated financial statements.

## Overstock.com, Inc.

## Consolidated Statements of Operations (unaudited)

## (in thousands, except per share data)

|  | Three months ended June 30, |  |  |  | Six months endedJune 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  | 2009 |  | 2010 |  | 2009 |  |
| Revenue, net |  |  |  |  |  |  |  |  |
| Direct | \$ | 42,382 | \$ | 28,685 | \$ | 92,950 | \$ | 63,567 |
| Fulfillment partner |  | 188,871 |  | 146,213 |  | 402,633 |  | 297,060 |
| Total net revenue |  | 231,253 |  | 174,898 |  | 495,583 |  | 360,627 |
| Cost of goods sold |  |  |  |  |  |  |  |  |
| Direct(1) |  | 37,434 |  | 23,532 |  | 81,018 |  | 53,929 |
| Fulfillment partner |  | 152,240 |  | 115,079 |  | 325,715 |  | 234,280 |
| Total cost of goods sold |  | 189,674 |  | 138,611 |  | 406,733 |  | 288,209 |
| Gross profit |  | 41,579 |  | 36,287 |  | 88,850 |  | 72,418 |
| Operating expenses: |  |  |  |  |  |  |  |  |
| Sales and marketing(1) |  | 14,179 |  | 11,162 |  | 28,458 |  | 24,749 |
| Technology(1) |  | 14,178 |  | 12,708 |  | 28,126 |  | 26,299 |
| General and administrative(1) |  | 14,503 |  | 12,326 |  | 29,409 |  | 26,160 |
| Restructuring |  |  |  | (66) |  | (136) |  | (66) |
| Total operating expenses |  | 42,860 |  | 36,130 |  | 85,857 |  | 77,142 |
| Operating income (loss) |  | $(1,281)$ |  | 157 |  | 2,993 |  | $(4,724)$ |
| Interest income |  | 40 |  | 27 |  | 56 |  | 150 |
| Interest expense |  | (760) |  | (808) |  | $(1,562)$ |  | $(1,730)$ |
| Other income, net |  | 652 |  | 954 |  | 1,023 |  | 2,690 |
| Income (loss) before taxes |  | $(1,349)$ |  | 330 |  | 2,510 |  | $(3,614)$ |
| Provision (benefit) for income taxes |  | (7) |  |  |  | 122 |  |  |
| Net income (loss) | \$ | $(1,342)$ | \$ | 330 | \$ | 2,388 | \$ | $(3,614)$ |
| Deemed dividend related to redeemable common stock |  | (63) |  | (11) |  | (77) |  | (22) |
| Net income (loss) attributable to common shares | \$ | $(1,405)$ | \$ | 319 | \$ | 2,311 | \$ | $(3,636)$ |
| Net income (loss) per common share basic: |  |  |  |  |  |  |  |  |
| Net income (loss) per common share basic | \$ | (0.06) | \$ | 0.01 | \$ | 0.10 | \$ | (0.16) |
| Weighted average common shares outstanding basic |  | 23,013 |  | 22,817 |  | 22,978 |  | 22,810 |
| Net income (loss) per common share diluted: |  |  |  |  |  |  |  |  |
| Net income (loss) per common share diluted | \$ | (0.06) | \$ | 0.01 | \$ | 0.10 | \$ | (0.16) |
| Weighted average common shares outstanding diluted |  | 23,013 |  | 23,049 |  | 23,329 |  | 22,810 |

(1) Includes stock-based compensation as follows (Note
9):

| Cost of goods sold direct | \$ | 53 | \$ | 40 | \$ | 102 | \$ | 84 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Sales and marketing |  | 153 |  | 161 |  | 303 |  | 303 |
| Technology |  | 271 |  | 235 |  | 522 |  | 471 |
| General and administrative |  | 793 |  | 729 |  | 1,558 |  | 1,506 |

## See accompanying notes to consolidated financial statements.

## Consolidated Statements of Stockholders Equity

and Comprehensive Income (Unaudited)

## (in thousands)

|  | Common stock |  |  | Additional <br> Paid-in <br> Capital |  | Accumulated Deficit |  | Treasury stock |  |  | Accumulated Other Comprehensive Income |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at December 31, 2009 | 25,583 | \$ | 2 | , | 343,040 | \$ | $(256,056)$ | 2,807 | \$ | $(76,186)$ | \$ | \$ | 10,800 |
| Exercise of stock options | 87 |  |  |  | 1,488 |  |  |  |  |  |  |  | 1,488 |
| Stock-based compensation to employees and directors |  |  |  |  | 2,485 |  |  |  |  |  |  |  | 2,485 |
| Common stock issued upon vesting of restricted stock | 184 |  |  |  |  |  |  |  |  |  |  |  |  |
| Purchase of treasury stock |  |  |  |  |  |  |  | 63 |  | (818) |  |  | (818) |
| Treasury stock issued for 401(k) matching contributions |  |  |  |  |  |  | (160) | (7) |  | 247 |  |  | 87 |
| Deemed dividend related to redeemable common stock (Note 10) |  |  |  |  | (77) |  |  |  |  |  |  |  | (77) |
| Comprehensive income: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net income |  |  |  |  |  |  | 2,388 |  |  |  |  |  | 2,388 |
| Total comprehensive income |  |  |  |  |  |  |  |  |  |  |  |  | 2,388 |
| Balance at June 30, 2010 | 25,854 | \$ | 2 | \$ | 346,936 | \$ | $(253,828)$ | 2,863 | \$ | $(76,757)$ | \$ | \$ | 16,353 |

See accompanying notes to consolidated financial statements.

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## Overstock.com, Inc.

## Consolidated Statements of Cash Flows (unaudited) (in thousands)



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| Fixed assets, including internal-use software and website development, costs financed <br> through accounts payable and accrued liabilities |  |  |  |
| :--- | :--- | :--- | :--- |
| Issuance of common stock from treasury for $401(\mathrm{k})$ matching contribution | $\$$ | 1,146 | $\$$ |
| Issuance of redeemable common stock | $\$$ | 87 | $\$$ |
| Lapse of recission rights of redeemable stock | $\$$ | $\$$ |  |
| Equipment and software acquired under capital least obligations | $\$$ | $\$$ | $\$$ |

See accompanying notes to consolidated financial statements.

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## 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 (SEC ) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and audited annual consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2009. 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 presentation of results for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management $s$ best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates. The results of operations for the three and six months ended June 30, 2010 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. All intercompany account balances and transactions have been eliminated in consolidation.

## Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, investment valuation, receivables valuation, revenue recognition, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets and internally-developed software, goodwill valuation, income taxes, stock-based compensation, and contingencies. Actual results could differ materially from those estimates.

The Company classifies all highly liquid instruments, including money market funds with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents as of June 30, 2010 and December 31, 2009 were $\$ 66.4$ million and $\$ 129.2$ million, respectively.

Restricted cash

The Company considers cash that is legally restricted and cash that is held as a compensating balance for letter of credit arrangements as restricted cash. At June 30, 2010 and December 31, 2009, restricted cash was $\$ 2.9$ million and $\$ 4.4$ million and was held primarily in money market accounts.

Fair value of financial instruments

The Company s financial instruments, including cash, cash equivalents, accounts receivable, accounts payable and accrued liabilities are carried at cost, which approximates their fair value because of the short-term maturity of these instruments.

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

- Level 1 Quoted prices for identical instruments in active markets;
- Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.


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

The fair value of these financial instruments was determined using the following levels of inputs as of June 30, 2010 (in thousands):

|  | Total |  | Fair Value Measurements at June 30, 2010: |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Assets: |  |  |  |  |  |  |  |
| Cash equivalents and restricted cash - Money market mutual funds | \$ | 69,300 | \$ | 69,300 | \$ | \$ |  |
| Trading securities held in a rabbi trust (1) |  | 63 |  | 63 |  |  |  |
| Total assets | \$ | 69,363 | \$ | 69,363 | \$ | \$ |  |
| Liabilities: |  |  |  |  |  |  |  |
| Restructuring accrual (2) | \$ | 2,352 | \$ |  | \$ | \$ | 2,352 |

The fair value of these financial instruments was determined using the following levels of inputs as of December 31, 2009 (in thousands):

|  |  | Fair Value Measurements at December 31, 2009: |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Total |  | Level 1 |  | Level 2 | Level 3 |  |
| Assets: |  |  |  |  |  |  |  |
| Cash equivalents and restricted cash - Money market mutual funds | \$ | 133,583 | \$ | 133,583 | \$ | \$ |  |
| Liabilities: |  |  |  |  |  |  |  |
| Restructuring accrual (2) |  | 2,685 | \$ |  | \$ | \$ | 2,685 |

(1) Trading securities held in a rabbi trust are included in Other long-term assets in the consolidated balance sheets (Note 12).
(2) The fair value was determined based on the income approach, in which the Company used internal cash flow projections over the life of the underlying lease agreements discounted based on a credit adjusted risk-free rate of return. See the Level 3 roll forward related to the restructuring accrual at Note 3 Restructuring Expense.

The estimated fair value of the Company s $3.75 \%$ Convertible Senior Notes due 2011 ( Senior Notes ) outstanding at June 30, 2010 and December 31, 2009 was $\$ 45.9$ million on a carrying value of $\$ 50.3$ million and $\$ 53.6$ million on a carrying value of $\$ 59.5$ million, respectively. The fair value of the Senior Notes was derived using a convertible debt pricing model with observable market inputs, which include stock price, dividend payments, borrowing costs, equity volatility, interest rates and interest spread.

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In December 2009, the Company implemented a Non Qualified Deferred Compensation Plan (the NQDC Plan ) for senior management (Note 12). Deferred compensation amounts are invested in mutual funds held in a rabbi trust and are restricted for payment to the participants of the NQDC Plan. The Company accounts for its investments held in the trust in accordance with Accounting Standards Codification ( ASC ) No. 320 Investments Debt and Equity Securities . The investments held in the trust are classified as trading securities. The fair value of the investments held in the trust totaled $\$ 63,000$ at June 30, 2010 and are included in Other long-term assets in the consolidated balance sheets. Our gains and losses on these investments were immaterial for the three and six months ended June 30, 2010.

Accounts receivable

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

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## Allowance for doubtful accounts

From time to time, the Company grants credit to some of its business customers on normal credit terms (typically 30 days). The Company performs credit evaluations of its customers financial condition and payment history and maintains an allowance for doubtful accounts receivable based upon its historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was $\$ 1.9$ million and $\$ 1.7$ million at June 30, 2010 and December 31, 2009, respectively.

## Concentration of credit risk

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At June 30, 2010 and December 31, 2009, two banks held the Company s cash and cash equivalents. The Company does not believe that, as a result of this concentration, it is subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash equivalents, and receivables. The Company invests its cash primarily in money market securities which are uninsured.

The Company s accounts receivable are derived primarily from revenue earned from customers located in the United States. The Company maintains an allowance for doubtful accounts based upon the expected collectability of accounts receivable.

## Valuation of inventories

The Company writes down its inventory for estimated obsolescence and to lower of cost or market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory allowance represents the new cost basis of such products. Reversal of the allowances is recognized only when the related inventory has been sold or scrapped. During the three months ended June 30, 2010, the Company wrote down seasonal inventory that was acquired during the quarter that was not selling as anticipated by approximately $\$ 550,000$.

Fixed assets

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

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|  | Life <br> (years) |
| :--- | ---: |
| Computer software | $2-3$ |
| Computer hardware | 3 |
| Furniture and equipment | $3-5$ |

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

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


Internal-use software and website development

The Company includes in fixed assets the capitalized cost of internal-use software and website development, including software used to upgrade and enhance its Website and processes supporting the Company s business. The Company capitalizes costs incurred during the application development stage of internal-use software and amortizes these costs over the estimated useful life of two to three years. The Company expenses costs incurred related to design or maintenance of internal-use software as incurred.

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During the three months ended June 30, 2010 and 2009, the Company capitalized $\$ 3.3$ million and $\$ 1.8$ million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was $\$ 1.6$ million and $\$ 1.5$ million for those respective periods. During the six months ended June 30, 2010 and 2009, the Company capitalized $\$ 5.1$ million and $\$ 2.5$ million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was $\$ 3.1$ million and $\$ 3.2$ million for those respective periods.

## Revenue recognition

The Company derives revenue primarily from two sources: direct revenue and fulfillment partner revenue, including listing fees and commissions collected from products being listed and sold through the Auctions tab of its Website as well as advertisement revenue derived from its cars and real estate listing businesses, and from advertising on its shopping pages. The Company has organized its operations into two principal segments based on the primary source of revenue: Direct revenue and fulfillment partner revenue (see Note 11 Business Segments).

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

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

The Company periodically provides incentive offers to its customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off current purchases, and other similar offers. Current discount offers, when used by customers, are treated as a reduction of revenue.

Based upon the Company s historical experience, revenue typically increases during the fourth quarter because of the holiday retail season.

## Co-branded credit card revenue

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During the six months ended June 30, 2009, the Company had a co-branded credit card agreement with a third-party bank, for the issuance of credit cards bearing the Overstock brand, under which the bank paid it fees for new accounts, renewed accounts and for card usage. New and renewed account fees were recognized as revenues on a straight-line basis over the estimated life of the credit card relationship. Credit card usage fees were recognized as revenues as actual credit card usage occurs. The Company s co-branded credit card agreement with the third-party bank terminated effective August 30, 2009.

In March 2010, the Company entered into a co-branded credit card agreement with a third-party bank for the issuance of credit cards bearing the Overstock.com brand, under which the bank will pay the Company fees for new accounts and for customer usage of the cards. The agreement also provides for a customer loyalty program offering reward points that customers will accrue from card usage and can use to make purchases on the Company s Website. The Company has not yet launched the co-branded card, and as such did not earn any revenues from the program during the six months ended June 30, 2010.

## Direct revenue

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

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## Fulfillment partner revenue

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

The Company provides an online auction service on its Website. The Auctions tab allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. Except in limited circumstances where the Company auction-lists returned merchandise, the Company is not the seller of auction-listed items and has no control over the pricing of those items. Therefore, the listing fees for items sold at auction by sellers are recorded as revenue during the period these items are listed or sold on a net basis. The revenue for the returned merchandise that the Company sells at auction is recorded on a gross basis. Revenue from the auctions business is included in the fulfillment partner segment.

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

The Company provides an online site for listing real estate for sale as a part of its Website. The real estate listing service allows customers to search active listings across the country. Listing categories include foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Revenue from the real estate business is included in the fulfillment partner segment on a net basis.

Total revenues from Auctions, Cars and Real Estate businesses were $\$ 661,000$ and $\$ 483,000$ for the three months ended June 30, 2010 and 2009 , respectively and $\$ 1.3$ million and $\$ 987,000$ for the six month periods ended June 30, 2010 and 2009 respectively.

The Company began selling products through its website to customers outside the United States in August 2008. As of June 30, 2010, the Company was offering products to customers in over 90 countries. The Company does not have operations outside the United States, and is using a U.S. based third party to provide logistics and fulfillment for all international orders. Revenue generated from the international business is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from the Company s leased warehouses or from a fulfillment partner.

Total revenues from International sales were $\$ 2.1$ million and $\$ 757,000$ for the three months ended June 30, 2010 and 2009, respectively and $\$ 4.5$ million and $\$ 1.5$ million for the six months ended June 30, 2010 and 2009 respectively.

In September 2009, the Company began offering a consignment service to suppliers where the suppliers merchandise is stored in and shipped from the Company s leased warehouses. The Company pays the consignment supplier upon sale of the consigned merchandise to the consumer.

In October 2009, the Company introduced O.biz, a website where customers and businesses can shop for bulk and business related items, while offering manufacturers, distributors and other retailers an alternative sales channel for liquidating their inventory.

## Deferred revenue

Customer orders are recorded as deferred revenue prior to estimated delivery of products or services. In addition, amounts received in advance for Club O membership fees are recorded as deferred revenue and recognized ratably over the membership period. The Company sells gift cards and records related deferred revenue at the time of the sale. Gift cards are sold without expiration dates and revenue is recognized upon redemption. If a gift card is not redeemed, the Company recognizes revenue when the likelihood of its redemption becomes remote based on the Company s historical redemption experience. The Company considers the likelihood of redemption to be remote after 36 months.

Sales returns allowance

The Company inspects all returned items when they arrive at the Company s processing facility. The Company will refund the full cost of the merchandise returned and all original shipping charges if the returned item is defective or there has been a Company error, such as shipping the wrong product.

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

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

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Total net revenue is recorded net of estimated returns. The Company records an allowance for returns based on current period revenues and historical returns experience. The Company analyzes actual historical returns, current economic trends and changes in order volume and acceptance of its products when evaluating the adequacy of the sales returns allowance in any accounting period. The Company s actual product returns have not differed materially from its estimates. The Company is not currently aware of any trends that it expects would significantly change future returns experience compared to historical experience. The allowance for returns was $\$ 6.3$ million and $\$ 11.9$ million at June 30, 2010 and December 31, 2009, respectively. The decrease in the sales returns reserve at June 30, 2010 compared to December 31, 2009 is primarily due to decreased revenues due to seasonality.

## Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. The Company maintains an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was \$120,000 and \$139,000 at June 30, 2010 and December 31, 2009 , respectively.

## Cost of goods sold

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

|  | Three months ended June 30, |  |  |  |  |  | Six months ended June 30, |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  |  | 2009 |  |  | 2010 |  | 2009 |  |  |
| Total revenue, net | \$ | 231,253 | 100\% | \$ | 174,898 | 100\% \$ | 495,583 | 100\% | \$ | 360,627 | 100\% |
| Cost of goods sold |  |  |  |  |  |  |  |  |  |  |  |
| Product costs and other cost of goods sold |  | 177,153 | 77\% |  | 128,898 | 73\% | 380,027 | 77\% |  | 267,464 | 74\% |
| Fulfillment costs |  | 12,521 | 5\% |  | 9,713 | 6\% | 26,706 | 5\% |  | 20,745 | 6\% |
| Total cost of goods sold |  | 189,674 | 82\% |  | 138,611 | 79\% | 406,733 | 82\% |  | 288,209 | 80\% |
| Gross profit | \$ | 41,579 | 18\% | \$ | 36,287 | 21\% \$ | 88,850 | 18\% | \$ | 72,418 | 20\% |

## Advertising expense

The Company expenses the costs of producing advertisements the first time the advertising takes place and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to the Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to the Company s Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled $\$ 12.1$ million and $\$ 10.2$ million during the three months ended June 30, 2010 and 2009, respectively. For the six months ended June 302010 and 2009, advertising expenses totaled $\$ 24.4$ million and $\$ 21.8$ million, respectively. Prepaid advertising, which consists primarily of prepaid advertising airtime, (included in Prepaids and other assets in the accompanying consolidated balance sheets) was $\$ 1.1$ million and $\$ 1.6$ million at June 30, 2010 and December 31, 2009, respectively.

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## Stock-based compensation

The Company measures compensation expense for all outstanding unvested share-based awards at fair value on date of grant and recognizes compensation expense over the service period for awards expected to vest on a straight line basis. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts will be recorded as an adjustment in the period estimates are revised. Management considers many factors when estimating expected forfeitures, including types of awards, and historical experience. Actual results may differ substantially from these estimates (see Note 9 Stock-Based Awards ).

## Loss contingencies

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

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## Restructuring

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

Income (loss) per share

Basic earnings (loss) per share is computed by dividing net income (loss) attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income (loss) attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, comprising incremental common shares issuable upon the exercise of stock options, convertible senior notes, and restricted stock units are included in the calculation of diluted earnings (loss) per common share to the extent such shares are dilutive.

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

|  | Three months ended June 30, |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  | 2009 |  | 2010 |  | 2009 |  |
| Net income (loss) | \$ | $(1,342)$ | \$ | 330 | \$ | 2,388 | \$ | $(3,614)$ |
| Deemed dividend related to redeemable common stock |  | (63) |  | (11) |  | (77) |  | (22) |
| Net income (loss) attributable to common shares | \$ | $(1,405)$ | \$ | 319 | \$ | 2,311 | \$ | $(3,636)$ |
| Weighted average common shares outstanding basic |  | 23,013 |  | 22,817 |  | 22,978 |  | 22,810 |
| Effect of dilutive securities: |  |  |  |  |  |  |  |  |
| Stock options and restricted stock units |  |  |  | 232 |  | 351 |  |  |
| Convertible senior notes |  |  |  |  |  |  |  |  |
| Weighted average common shares outstanding diluted |  | 23,013 |  | 23,049 |  | 23,329 |  | 22,810 |
| Net income (loss) per common share basic | \$ | (0.06) | \$ | 0.01 | \$ | 0.10 | \$ | (0.16) |
|  |  |  |  |  |  |  |  |  |
| Net income (loss) per common share diluted | \$ | (0.06) | \$ | 0.01 | \$ | 0.10 | \$ | (0.16) |

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

|  | Three months ended June 30, |  | Six months ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  |  | June 30, |  |
|  | 2010 | 2009 | 2010 | 2009 |
| Stock options and restricted stock units | 1,267 | 1,219 | 569 | 1,451 |
|  |  |  |  |  |
| Convertible senior notes | 665 | 820 | 665 | 820 |

Accounting pronouncements issued not yet adopted

In January 2010, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2010-06, Improving Disclosures About Fair Value Measurements, which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair- value measurements. ASU 2010-6 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. The Company does not expect the remaining adoption of ASU 2010-06 related to the reconciliation of Level 3 fair value measurements in 2010 to have a material impact on its consolidated financial statements.

## 3. RESTRUCTURING EXPENSE

During the fourth quarter of 2006, the Company began a facilities consolidation and restructuring program designed to reduce the overall expense structure in an effort to improve future operating performance. The facilities consolidation and restructuring program was substantially completed by the end of the second quarter of 2007.

Restructuring liabilities along with charges to expense associated with the facilities consolidation and restructuring program are as follows as of June 30, 2010 (in thousands):

|  | Balance <br> $\mathbf{1 2 / 3 1 / 2 0 0 9}$ | Accretion <br> Expense | Net Cash <br> Payments | Adjustments |  | Balance <br> $\mathbf{6 / 3 0 / 2 0 1 0}$ |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Lease and termination costs | $\$$ | 2,685 | $\$$ | 126 | $\$$ | $(323)$ | $\$$ | $(136)$ | $\$$ | 2,352 |

There were no restructuring charges during the three months ended June 30, 2010. The Company reversed $\$ 136,000$ of lease termination costs liability during the six months ended June 30, 2010 due to changes in the estimate of sublease income, primarily as a result of the Company entering into an agreement with a sublessee to terminate the sublease and have the Company re-occupy a portion of the space previously abandoned, due to the Company s growth and need for additional space. During the three and six months ended June 30, 2009, the Company reversed $\$ 66,000$ of lease termination costs liability due to changes in our estimate of sublease income, primarily as a result of entering into a sublease agreement for previously vacant space.

## 4. COMPREHENSIVE INCOME (LOSS)

The Company s comprehensive income (loss) is as follows (in thousands):

|  | Three months ended June 30, |  |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  | 2009 |  |  | 2010 |  | 2009 |  |
| Net income (loss) | \$ | $(1,342)$ | \$ |  | 330 | \$ | 2,388 | \$ | $(3,614)$ |
| Reclassification adjustment for amounts included in net loss |  |  |  |  |  |  |  |  | (48) |
| Comprehensive income (loss) | \$ | $(1,342)$ | \$ |  | 330 | \$ | 2,388 | \$ | $(3,662)$ |

## 5. BORROWINGS

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On December 23, 2009, the Company entered into a Financing and Security Agreement dated December 22, 2009 (the Financing Agreement ) with U.S. Bank National Association ( U.S. Bank ). The Financing Agreement replaces a former credit agreement with Wells Fargo.

The Financing Agreement provides for revolving loans and other financial accommodations to or for the benefit of the Company of (i) up to $\$ 10$ million for cash-collateralized advances, and (ii) up to $\$ 10$ million for advances supported by the Company s non-cash collateral. The maximum credit potentially available under the revolving facility is $\$ 20$ million. The Company s obligations under the Financing Agreement and all related agreements are secured by all or substantially all of the Company s assets, excluding its interest in certain litigation. Subject to certain exceptions, the full amount of the revolving facility is expected to be available to the Company as long as $\$ 20$ million is maintained on deposit with U.S. Bank. The obligation of U.S. Bank to make advances under the Financing Agreement is subject to the conditions set forth in the Financing Agreement.

The Company s failure to keep at least $\$ 20$ million on deposit in certain accounts with U.S. Bank would constitute a triggering event under the Financing Agreement. If a triggering event occurs, the Company would become subject to financial covenants (i) limiting the Company s capital expenditures to $\$ 20$ million annually, and (ii) requiring the Company to maintain a fixed charges coverage ratio of at least 1.10 to 1.00 as of the end of any fiscal quarter for the period of the prior four quarters. The occurrence of a triggering event could also result in a decrease in the amount available to the Company under the non cash-collateralized portion of the facility, as availability would then depend, in part, on the Borrowing Base (as defined in the Financing Agreement). The Financing Agreement and the credit facility terminate on October 2, 2011. As of June 30, 2010, the Company had $\$ 20.0$ million in compensating cash balances held at U.S. Bank.

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Subject to certain interest rate floors and other exceptions, advances under the Financing Agreement bear interest at either (a) Libor plus $1 \%$ for cash-collateralized financing, including letters of credit, or (b) Libor plus $2.5 \%$ for non cash- collateralized advances. The default rate of interest is $2.0 \%$ per annum over the otherwise applicable interest rate. An unused line fee of $0.375 \%$ is payable monthly on the unused portion of the $\$ 10$ million facility available for non cash-collateralized advances.

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

With certain exceptions, a termination fee of up to $1.0 \%$ of the non cash-collateralized portion of the facility is payable by the Company if the Company terminates the facility prior to its stated termination date.

No amounts were outstanding under the Financing Agreement at June 30, 2010 and December 31, 2009, and letters of credit totaling $\$ 2.8$ million and $\$ 2.6$ million, respectively, were issued on behalf of the Company collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets.

## U.S. Bank Commercial Purchasing Card Agreement

On December 16, 2009, the Company entered into a commercial purchasing card agreement (the Purchasing Card ) with U.S. Bank. The Company uses the Purchasing Card for business purpose purchasing and must pay it in full each month. At June 30, 2010, $\$ 2.1$ million was outstanding and $\$ 2.9$ million was available under the Purchasing Card. At December 31, 2009, no amount was outstanding and $\$ 5.0$ million was available under the Purchasing Card.

## Capital leases

The Company leased certain software and computer equipment during the year ended December 31, 2009, under non-cancelable leases that expire on various dates through 2012.

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Software and equipment relating to the capital leases totaled $\$ 1.7$ million at June 30, 2010 and December 31, 2009, with accumulated depreciation of $\$ 612,000$ and $\$ 335,000$, respectively. Depreciation expense of assets recorded under capital leases was $\$ 145,000$ and $\$ 41,000$ for the three months ended June 30, 2010 and 2009, respectively. Depreciation expense of assets recorded under capital leases was $\$ 290,000$ and $\$ 515,000$ for the six months ended June 30, 2010 and 2009, respectively.

Future payments of capital lease obligations are as follows (in thousands):

| Payments due by period |  |  |
| :--- | ---: | ---: |
| 2010 (remainder) |  | 199 |
| 2011 |  | 793 |
| 2012 | 111 |  |
| Total minimum lease payments | 1,103 |  |
| Less: amount representing interest | 134 |  |
| Present value of capital lease obligations | 969 |  |
| Less: current portion |  | 701 |
| Capital lease obligations, non-current | $\$$ | 268 |

### 3.75\% Convertible Senior Notes

In November 2004, the Company completed an offering of $\$ 120.0$ million of $3.75 \%$ Convertible Senior Notes due 2011 (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 effective

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interest method. The Company recorded amortization of discount and debt issuance costs related to this offering totaling $\$ 66,000$ and $\$ 71,000$ during the three months ended June 30, 2010 and 2009, respectively and $\$ 134,000$ and $\$ 144,000$ during the six months ended June 30, 2010 and 2009, respectively. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

The Senior Notes are convertible at any time prior to maturity into the Company s common stock at the option of the note holders at a conversion price of $\$ 76.23$ per share or, approximately 665,000 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). The Company has the right to redeem the Senior Notes, in whole or in part, for cash at $100 \%$ of the principal amount plus accrued and unpaid interest. Upon the occurrence of a fundamental change (including the acquisition of a majority interest in the Company, certain changes in the Company s board of directors or the termination of trading of the Company s stock) meeting certain conditions, holders of the Senior Notes may require the Company to repurchase, for cash, all or part of their notes at $100 \%$ of the principal amount plus accrued and unpaid interest.

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

## 6. COMMITMENTS AND CONTINGENCIES

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of June 30, 2010, are as follows (in thousands):

| Payments due by period |  |  |
| :--- | ---: | ---: |
| 2010 (remainder) |  | 4,385 |
| 2011 |  | 8,606 |
| 2012 | 8,064 |  |
| 2013 |  | 7,421 |
| 2014 | 7,615 |  |
| Thereafter | 7,312 |  |
|  | $\$$ | 43,403 |

Rental expense for operating leases totaled $\$ 2.0$ million and $\$ 1.8$ million for the three months ended June 30, 2010 and 2009, respectively. For the six month period ended June 30, 2010 and 2009, rental expense totaled $\$ 4.0$ million and $\$ 3.6$ million, respectively. Estimated sublease income of $\$ 4.5$ million is expected over the next five years of which $\$ 954,000$ is anticipated to be received in the next 12 months.

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## Legal Proceedings

From time to time, the Company receives claims of and becomes subject to consumer protection, employment, intellectual property and other commercial litigation related to the conduct and operation of the Company sbusiness and the sale of products on the Company s Website. In connection with such litigation, the Company may be subject to significant damages. We may also be subject to equitable remedies and penalties. Such litigation could be costly and time consuming and could divert or distract Company management and key personnel from its business operations. The Company does not currently believe that any of its outstanding litigation will have a material adverse effect on its financial statements or business. However, due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect the Company s business, results of operations, financial position, or cash flows.

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. In September 2007, the Company filed an amended complaint adding two plaintiff shareholders, naming Lehman Brothers Holdings Inc. as a defendant, eliminating the previous claim of intentional interference with prospective economic advantage and clarifying various points of other claims in the original complaint. The suit alleged that the defendants, who control over $80 \%$ of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as fails to deliver and that the defendants actions caused and continue to cause dramatic distortions within the nature and amount of trading in 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 accused the defendants of violations of California securities laws and common law, specifically, conversion, trespass to chattels, intentional interference with prospective economic advantage, and violations of California s Unfair Business Practices Act. In April 2007, defendants filed a demurrer and motion to strike the Company s complaint. The Company opposed the demurrer and motion to strike. In July 2007 the court substantially denied defendants demurrer and motion to strike. In November 2007, the defendants filed additional motions to strike. In February 2008, the court denied defendants motion to strike the Company s claims under California s Securities Anti-Fraud statute and defendants motion to strike the Company s common law punitive damages claims, but granted in part the defendants motion to strike Overstock s claims under California $s$ Unfair Business Practices Act, while allowing the Company s claims for injunctive relief under California s Unfair Business Practices Act. Lehman Brothers Holdings filed for bankruptcy on September 15, 2008 and Barclays Bank has purchased its investment banking and trading business. The Company elected not to pursue its claims against Lehman Brothers Holdings in the bankruptcy proceedings. Dislocations in the financial markets and economy could result in additional bankruptcies or consolidations that may impact the litigation or the ability to collect a

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judgment. On January 12, 2009, Goldman Sachs Group, Inc., Goldman Sachs \&Co., Goldman Sachs Execution \& Clearing L.P., Citigroup, Inc, Citigroup Global markets, Inc., Credit Suisse (USA) Inc., and Credit Suisse Securities (USA) LLC filed a motion to strike portions of the Second Amended Complaint regarding certain allegations of conspiracy among defendants and the request for punitive damages. Also, on January 12, 2009, Goldman Sachs Group, Inc., Goldman Sachs \&Co., Goldman Sachs Execution \& Clearing L.P., Citigroup, Inc, Citigroup Global markets, Inc., Credit Suisse (USA) Inc., and Credit Suisse Securities (USA) LLC filed a demurrer to the first and second causes of action for conversion and trespass to chattels and a motion to strike various other allegations of the Second Amended Complaint. On March 19, 2009, the Court sustained the demurrer to first and second causes of action but granted leave to amend the complaint. The motion to strike was denied. On April 20, 2009, the Company amended its complaint against all the defendants, re-pleading conversion and trespass to chattels causes of action. Defendants again filed demurrer to the amended complaint and, on July 23, 2009, the court sustained the demurrer. Discovery in this case continues. A trial date has been set for September 12, 2011. The Company intends to continue to vigorously prosecute this action.

On April 15, 2008, the Company received a letter from the Office of the District Attorney of Marin County, California, stating that the District Attorneys of Marin and four other counties in Northern California have begun an investigation into the way the Company advertises products for sale, together with an administrative subpoena seeking related information and documents. The subpoena requests a range of documents, including documents relating to pricing methodologies, definitions of core and partner product, as well as other site-defined terms, and the methods of internal and external pricing of products, as well as documents related to the pricing of a list of product items identified in the subpoena. The Company has responded to the subpoena and has engaged in resolution discussions with these authorities. In January 2010, attorneys for the Company received correspondence from the Office of the District Attorney of County of Santa Clara in which the same offices of the various district attorneys made a collective proposal to resolve the dispute by the Company s payment of $\$ 8.5$ million. In March 2010, the Company received correspondence from the Office of the District Attorney of the County of Monterey in which the respective offices of the various district attorneys have made a collective proposal to resolve the dispute by the Company s payment of $\$ 7.5$ million in penalties and reimbursement. The Company disagrees with the proposal and continues to discuss this matter with the authorities involved. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. The Company believes that it follows industry advertising practices and intends to continue to cooperate with the investigation.

On May 30, 2008 the Company filed a complaint in New York state court against the New York State Department of Taxation and Finance, its Commissioner, the State of New York and its governor, alleging that a recently enacted New York state tax law is unconstitutional. The effect of the New York law is to require Internet sellers to collect and remit New York sales taxes on their New York sales even if the seller has no New York tax nexus other than with New York based independent contractors who are Internet advertising affiliates. The complaint asks for the court to declare the law unconstitutional and enjoin its application to the Company. New York filed a motion to dismiss. The Company responded to the motion and filed a motion for summary judgment, and both motions were heard simultaneously. On January 12, 2009, the court granted New York s motion to dismiss and denied the Company s motion for summary judgment. On February 12, 2009, the Company filed notice of appeal, and argued the appeal on October 29, 2009. The appeal is still pending before the New York Supreme Court, Appellate Division.

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

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On November 14, 2008, the Company filed suit in Ohio state court against the Ohio Tax Commissioner, the Ohio Attorney General and the Governor of Ohio, alleging the Ohio Commercial Activity Tax is unconstitutional. Enacted in 2005, Ohio s Commercial Activity Tax is based on activities in Ohio that contribute to production or gross income for a company whether or not the company has a physical presence in or nexus within the state. The Company s complaint asked for a judgment declaring the tax unconstitutional and for an injunction preventing any enforcement of the tax. The defendants moved to dismiss the case. On July 28, 2009, the trial court ruled that there was no justiciable controversy in the case, as the Company had not yet been assessed a tax, and it granted the defendants motions to dismiss. In September 2009, the Company received a letter of determination from the Ohio Department of Taxation noting the Department s determination that the Company is required to register for remitting of the Commercial Activity Tax, and owes $\$ 612,784$ in taxes, interest, and penalties as of June 30, 2009. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. The Company believes the determinations to be unlawful, erroneous and is vigorously contesting the determination.

On March 10, 2009, the Company was sued in a class action filed in the United States District Court, Eastern District of New York. Cynthia Hines, the nominative plaintiff on behalf of herself and others similarly situated, seeks damages under claims for breach of contract, common law fraud and New York consumer fraud laws. The Plaintiff alleges the Company failed to properly disclose its returns policy to her and that it improperly imposed a restocking charge on her return of a vacuum cleaner. The Company filed a motion to dismiss based upon assertions that the Company s agreement with its customers requires all such actions to be arbitrated in Salt Lake City, Utah. Alternatively, the Company asked that the case be transferred to the United States District Court for the District of Utah, so that arbitration may be compelled in that district. On September 8, 2009 the motion to dismiss or transfer was denied, the court stating that the Company s browsewrap agreement was insufficient under New York law to establish an agreement with the customer to arbitrate disputes in Utah. On October 8, 2009, the Company filed a Notice of Appeal of the court s ruling. The appeal was denied. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. However no estimate of the loss or range of loss can be made. The suit is in its early stages, and the Company intends to vigorously defend this action.

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

On or about September 25, 2009 Alcatel-Lucent USA, Inc. filed suit against the Company and 12 other defendants in the United States District Court in the Eastern District of Texas. The Company is alleged to have infringed three Internet-related and search software patents. The Company believes that certain third party vendors of products and services sold to the Company are contractually obligated to indemnify the Company in this action. The Company has answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. However no estimate of the loss or range of loss can be made. The Company intends to vigorously defend this action and pursue its indemnification rights with its vendors.

On or about November 11, 2009 Downunder Wireless, LLC filed suit against the Company and 21 other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent for cell phones with a downward deploying antenna, angled away from the user s face. Other named defendants are retailers or manufacturers of cell phones which allegedly infringe this patent. The Company believes that certain third party vendors of cell phone products sold to the Company are contractually obligated to indemnify the Company in this action. The Company answered the complaint and moved, along with other defendant retailers for a stay of the action pending the outcome of the case against manufacturers. In response Downunder voluntarily requested that the Company and other retailer defendants be dismissed from the case, and on May 18, 2010, the court dismissed the Company and the other retailers.

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On or about December 16, 2009 Denmel Holdings, LLC filed suit against the Company and 25 other defendants in the United States District Court in the Central District of Utah for infringement of a patent for a device used to house and recharge several electronic devices, such as cell phones and pagers. The Company believes that certain third party vendors of such devices sold to the Company are contractually obligated to indemnify the Company in this action. By agreement, the Company has not yet answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. However no estimate of the loss or range of loss can be made. The Company intends to vigorously defend this action and pursue its indemnification rights with its vendors.

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On or about January 15, 2010 the Center for Environmental Health filed suit against the Company and 138 other defendants in Superior Court of California, County of Alameda, for selling handbags that allegedly exceed the allowable lead content limits specified in California Proposition 65. The Company s supplier of the goods specified in the complaint is providing for the Company s defense in the action pursuant to its contractual indemnification obligations. The Company has not yet answered the complaint. In April 2010 the court approved a stipulated settlement among the parties which resolved the case without requirement of financial contribution from the Company. The case is now concluded.

On or about January 15, 2010 Nancy Davis LLC filed suit against the Company in the United States District Court in the Central District of California for trademark infringement for heart-shaped, peace sign jewelry. The Company believes that certain third party vendors of such products sold to the Company are contractually obligated to indemnify the Company in this action. The Company has answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. However no estimate of the loss or range of loss can be made. The Company intends to vigorously defend this action and pursue its indemnification rights with its vendors.

On May 11, 2010 Site Update Solutions, LLC filed suit against the Company and 34 other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent claiming a process for maintaining ongoing registration for pages on a given search engine ... a method to actively cause an updating of a specific internet search engine database regarding a particular WWW resource. The Company has answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. However no estimate of the loss or range of loss can be made. The Company intends to vigorously defend this action and pursue its indemnification rights with its vendors.

On July 2, 2010 AdjustaCam LLC filed suit against the Company and 59 other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent covering hinged apparatuses for supporting cameras The Company believes that if called upon to defend the action, certain third party vendors of such devices sold to the Company are contractually obligated to indemnify the Company in this action. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against the Company are described above. However no estimate of the loss or range of loss can be made. If served with summons and complaint, the Company would vigorously defend this action and pursue its indemnification rights with its vendors.

The Company has received a notice from the Securities and Exchange Commission (SEC ) stating that the SEC is conducting an investigation concerning the Company s previously-announced financial restatements of 2006 and 2008 and other matters. The subpoena accompanying the notice covers documents related to the restatements and also to the Company s billings to its partners in the fourth quarter of 2008 and related collections, and its accounting for and implementation of software relating to its accounting for customer refunds and credits, including offsets to partners, and related matters. The Company has been and will continue cooperating fully with the investigation.

The Company establishes liabilities when a particular contingency is probable and estimable. The Company believes the $\$ 1.1$ million accrued at June 30, 2010 in its consolidated financial statements is adequate in light of the probable and estimable liabilities. It is reasonably possible that the potential losses may exceed our accrued liabilities.

The Company has other contingencies which are reasonably possible; however, the reasonably possible exposure to losses cannot currently be estimated.

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The Company recognized a reduction in legal expenses of $\$ 600,000$ and $\$ 1.2$ million during the three and six months ended June 30, 2009, respectively, related to the settlement of legal matters. There were no amounts received related to the settlement of legal matters during the six months ended June 30, 2010.

## 7. 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

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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.

## 8. STOCK AND DEBT REPURCHASE PROGRAM

On February 17, 2009, the Board of Directors approved a debt repurchase program that authorizes the Company to use up to $\$ 20.0$ million in cash to repurchase a portion of its Senior Notes. Under this repurchase program, the Company retired $\$ 9.3$ million of the Senior Notes during the six months ended June 30,2010 for $\$ 9.0$ million in cash, resulting in a gain of $\$ 204,000$ on early extinguishment of debt, net of $\$ 66,000$ of associated unamortized discount. The Company retired $\$ 7.4$ million of the Senior Notes during the six months ended June 30, 2009 for $\$ 4.6$ million in cash, resulting in a gain of $\$ 2.8$ million on early extinguishment of debt, net of $\$ 92,000$ of associated unamortized discount. As of June 30, 2010 and December 31, 2009, $\$ 50.3$ million and $\$ 59.5$ million of the Senior Notes remained outstanding, respectively.

During the three months ended June 30, 2010 and 2009, the Company withheld from vesting restricted stock awards totaling approximately 1,000 and 645 shares of its common stock for $\$ 26,000$ and $\$ 7,000$ respectively. During the six months ended June 30, 2010 and 2009, the Company withheld from vesting restricted stock awards totaling approximately 63,000 and 36,000 shares of its common stock for $\$ 818,000$ and $\$ 334,000$ respectively. The shares withheld represented the minimum tax withholdings upon the vesting of those restricted stock award grants to satisfy the minimum tax withholdings owed by the grantee of the restricted stock award grant. None of these shares were repurchased in the open market.

## 9. STOCK-BASED AWARDS

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

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

|  | Three months ended June 30, |  |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  |  | 2009 |  | 2010 |  | 2009 |  |
| Stock options | \$ | 408 | \$ |  | 576 | \$ | 873 | \$ | 1,233 |
| Restricted stock awards |  | 862 |  |  | 589 |  | 1,612 |  | 1,131 |
| Total stock-based compensation expense | \$ | 1,270 | \$ |  | 1,165 | \$ | 2,485 | \$ | 2,364 |

Stock options

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The exercise price of each stock option granted under the Company s employee equity incentive plans is equal to or greater than the market price of its common stock on the date of grant. Generally, option grants vest over four years, expire no later than ten years from the grant date and are subject to the employee s continuing service to the Company. The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton ( BSM ) option pricing model. There were no option grants for the three and six months ended June 30, 2010 and 2009.

The computation of the expected volatility assumption used in the BSM pricing model for new grants is based on the Company s historical stock prices over the expected term. The Company elected to use the simplified method as discussed in SEC Staff Accounting Bulletin ( SAB ) No. 107, Share Based Payment ( SAB No. 107 ), to develop an expected term. In December 2007, the SEC issued SAB No. 110, Certain Assumptions Used in Valuation Methods-Expected Term ( SAB No. 110 ). According to SAB No. 110, under certain circumstances the SEC staff will continue to accept the use of the simplified method as discussed in SAB No. 107, in developing an estimate of expected term of plain vanilla share options in accordance with ACS topic 718, beyond December 31, 2007. The risk-free interest rate for the period within the expected term of the option is based on the yield of United States Treasury notes in effect at the time of grant. The Company has not historically paid dividends; thus, the expected dividend yield used in the calculation is zero.

Restricted stock awards

During the six months ended June 30, 2010, the Compensation Committee of the Board of Directors approved grants of 290,000 restricted stock awards to officers and employees of the Company. The restricted stock awards vest over three years at $25 \%$ at the end of the first year, $25 \%$ at the end of the second year and $50 \%$ at the end of the third year and are subject to the employee s continuing service to the Company. At June 30, 2010, there were 687,000 restricted stock awards that remained outstanding.

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The cost of restricted stock awards is determined using the fair value of the Company s common stock on the date of the grant, and compensation expense is recognized on a straight line basis over the three year vesting schedule. The weighted average grant date fair value of restricted stock awards granted during the three and six months ended June 30, 2010 was $\$ 23.19$ and $\$ 13.04$ per share, respectively.

The following table summarizes restricted stock award activity during the six months ended June 30, 2010 (in thousands):

|  | 20010 |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
|  | Awards |  | Weighted Average Grant <br> Date Fair Value |  |
| Outstanding beginning of year | 640 | $\$$ | 11.35 |  |
| Granted at fair value | 290 |  | 13.04 |  |
| Vested | $(184)$ |  | 11.77 |  |
| Forfeited | $(59)$ |  | 11.59 |  |
| Outstanding end of period | 687 | $\$$ | 12.02 |  |

## 10. REDEEMABLE COMMON STOCK

In June 2009, the Company discovered that it inadvertently issued 203,737 more shares of the Company s common stock in connection with its $401(\mathrm{k})$ plan than had been registered with the Securities and Exchange Commission for offer in connection with the 401(k) plan. These shares were contributed to or otherwise acquired by participants in the $401(\mathrm{k})$ plan between August 16, 2006, and June 17, 2009. As a result, certain participants in the $401(\mathrm{k})$ plan may have or have had rescission rights relating to the unregistered shares, although the Company believes that the federal statute of limitations applicable to any such rescission rights would be one year, and that the statute of limitations had already expired at September 30, 2009 with respect to most of the inadvertent issuances. At June 30, 2010 and December 31, 2009, approximately 65,000 shares or $\$ 821,000$ and 65,000 shares or $\$ 744,000$, respectively, of the Company s common stock including interest were classified outside stockholders equity because of the potential rescission rights.

On August 31, 2009, the Company entered into a Tolling and Standstill Agreement (the Agreement ) with the Overstock.com, Inc. Employee Benefits Committee (the Committee ) relating to the Overstock.com, Inc. 401(k) plan (the Plan ). The Company entered into the Agreement in order to preserve certain rights, if any, of Plan participants who acquired shares of Overstock common stock in the Plan between July 1, 2008 and June 30, 2009. The Company intends to make a rescission offer to affected participants in the Plan who acquired shares of Overstock common stock between July 1, 2008 and June 30, 2009, subject to compliance with applicable regulatory matters.

Based on the closing price of Overstock common stock of $\$ 18.07$ at June 30, 2010, the Company anticipates that of the $\$ 821,000$ of affected stock outstanding as of June 30, 2010, it would be uneconomical for participants to attempt to rescind their acquisitions of more than $\$ 155,000$ of the stock which represents the dollar amount of common stock that was acquired by the participants at a per share price greater than $\$ 18.07$ and therefore these purchasers are the ones more likely to accept the offer. The actual amount of the Company s potential liability will be determined based on the Company s closing stock price on the date of expiration of the rescission offer, as under the anticipated terms of the rescission offer we will not repurchase shares if the amount paid by participants for the shares, plus interest, is less than our closing stock price on the date of the expiration of the rescission offer (as such participants would be in a position of having an unrealized gain, not a loss).

## 11. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 Segment Reporting. Segments were determined based on products and services provided by each segment. There were no inter-segment sales or transfers during the three and six months ended June 30, 2010 and 2009. The Company evaluates the performance of its segments and allocates resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three and six months ended June 30, 2010 and 2009 (in thousands):

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

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

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

For the three and six months ended June 30, 2010 and 2009, over $99 \%$ of sales were made to customers in the United States of America. At June 30, 2010 and December 31, 2009, all of the Company s fixed assets were located in the United States of America.

## 12. EMPLOYEE RETIREMENT PLAN

In December 2009, the Company implemented a Non Qualified Deferred Compensation plan for senior management. The plan allows eligible members of senior management to defer their receipt of compensation from the Company, subject to the restrictions contained in the plan. Participants are $100 \%$ vested in their deferred compensation amounts and the associated gains or losses. For Company contributions, if any, and the associated gains or losses the participants shall vest in those deferred compensation amounts according to a vesting schedule that the Company shall determine at the time the Company contribution is made. As of June 30, 2010, no Company contributions have been made into the NQDC Plan. Participants are generally eligible to receive distributions from the plan two plan years subsequent to the plan year their initial deferral contribution is made. Deferred compensation amounts are held in a rabbi trust, which invests in mutual funds. The trust assets, which

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consist of mutual funds, are recorded in the Company s consolidated balance sheets because they are subject to the claims of the Company s creditors. The corresponding deferred compensation liability represents the amounts deferred by the plan participants plus or minus any earnings or losses on the trust assets. The trust s assets totaled $\$ 63,000$, while the NQDC Plan s liabilities totaled $\$ 69,000$ at June 30, 2010. The assets and liabilities of the NQDC Plan were included in Other long-term assets and Other long-term liabilities in the consolidated balance sheets. The gains and losses on the NQDC Plan s assets were immaterial for the three and six months ended June 30, 2010.

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

Special Note Regarding Forward-Looking Statements


#### Abstract

In addition to historical information, this Quarterly Report on Form 10-Q 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 other businesses; our beliefs, intentions and expectations regarding promotion of new or complimentary product and sales formats; our beliefs, 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 complementary 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; our beliefs and expectations regarding interest rate risk, our investment activities and the effect of changes in interest rates; the possibility that we will relocate our corporate offices or consolidate our warehouses; and our expectations regarding future depreciation expense and other future expenses.


These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially for a variety of reasons, including, among others, changes in global economic conditions and consumer spending, world events, the rate of growth of the Internet and online commerce, the amount that we invest in new business opportunities and the timing of those investments, the mix of products sold to customers, the extent to which we owe income and other taxes, competition, management of growth, potential fluctuations in operating results, international growth and expansion, fluctuations in foreign exchange rates, the outcomes of legal proceedings and claims, fulfillment center optimization, risks of inventory management, seasonality, the degree to which we enter into, maintain, and develop commercial agreements, acquisitions, and strategic transactions, payments risks, and risks of fulfillment throughput and productivity. In addition, the current global economic climate amplifies many of these risks. Descriptions of the material risks we face and additional information regarding factors that could materially affect results and the accuracy of the forward-looking statements contained herein may be found in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

## Overview

We are an online retailer offering closeout and discount brand and non-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 sell these products through an internet website located at www.overstock.com ( Website ). We also sell books, magazines, CDs, DVDs and video

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games ( BMMG ). We also operate as part of our Website an online auctions business a marketplace for the buying and selling of goods and services as well as online sites for listing cars and real estate for sale. In October 2009, we also launched O.biz, a website where customers can shop for bulk and business related items. Though our two websites are located at different domain addresses, the technology and equipment and processes supporting the Overstock.com Website and the process of order fulfillment described herein are the same for the O.biz website.

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

## Our Business

We provide manufacturers with a one-stop liquidation channel to sell both large and small quantities of excess and closeout inventory without disrupting sales through traditional channels. Much of the merchandise offered on our Website is from well-known, brand-name manufacturers. In the Shopping Section of our Website, we currently have approximately 651,000 BMMG products and approximately 170,000 non-BMMG products in eleven major departments. Our customers are able to access and purchase our products 24 hours a day from the convenience of their computer, mobile telephone or other Internet-enabled device. Our team of customer service representatives assists customers by telephone, instant online chat and e-mail. Our objective is to become the

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dominant Internet-based closeout solution for holders of brand-name merchandise, allowing them to dispose of that merchandise discreetly and with high recovery values, and to ultimately become a one-stop Internet-based discount shopping destination.

We use the Internet to create a more efficient market for liquidation, closeout and other discount merchandise. We provide consumers and businesses with quick and convenient access to high-quality, brand-name merchandise at discount prices. We have organized our shopping business (sales of product offered through the Shopping Section of our Website) into two principal segments a direct business and a fulfillment partner business. Virtually all of our sales are to customers located in the United States. Less than $1 \%$ of our sales are made indirectly to international customers. During the six months ended June 30, 2010 and 2009, no single customer accounted for more than $1 \%$ of our total revenue.

## Direct business

Our direct business includes sales made to individual consumers and businesses, which are fulfilled from our leased warehouses in Salt Lake City, Utah. Our warehouses generally ship between 5,000 and 8,000 orders per day and up to approximately 32,000 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 record revenue from the majority of these sales transactions on a gross basis. Our use of the term partner or fulfillment partner does not mean that we have formed any legal partnerships with any of our fulfillment partners. We currently have fulfillment partner relationships with approximately 1,340 third parties which post approximately 159,000 non-BMMG products, as well as most of the BMMG products, on our Website. Revenue generated from sales on our Shopping site from both the direct and fulfillment partner businesses is recorded net of returns, coupons and other discounts.

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

Unless otherwise indicated or required by the context, the discussion herein of our consolidated financial statements, accounting policies and related matters, pertains to the Shopping Section of our Website and our O.biz website and not necessarily to the much smaller Auctions, Cars or Real Estate sections of our Website.

## Consignment

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In September 2009, we began offering a consignment service to suppliers where the suppliers merchandise is stored in and shipped from our leased warehouses. We pay the consignment supplier upon sale of the consigned merchandise to the consumer. Revenue from our consignment service business is included in the fulfillment partner segment.

## Auctions business

We operate an online auction service as part of our Website. Our auction service allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. 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 business through our auction service, and for these sales, we record the revenue on a gross basis. Revenue from our auction business is included in the fulfillment partner segment.

Car listing business

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

Real Estate listing business

We operate an online site for listing real estate for sale as a part of our Website. The real-estate listing service allows customers to search active listings across the country. Listing categories include foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Revenue from the real estate business is included in the fulfillment partner segment.

## International business

We began selling products through our Website to customers outside the United States in late August 2008. As of June 30, 2010, we are offering products to customers in over 90 countries. We do not have operations outside the United States, and are using a

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U.S. based third party to provide logistics and fulfillment for all international orders. Revenue generated from our international business is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our warehouses or from a fulfillment partner.
O.biz

In October 2009, we introduced O.biz, a website where customers and businesses can shop for bulk and business related items, offering manufacturers, distributors and other retailers an alternative sales channel for liquidating their inventory. Revenue generated from our O.biz website is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our warehouses or from a fulfillment partner.

## Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The Securities and Exchange Commission ( SEC ) has defined a company s critical accounting policies as the ones that are most important to the portrayal of the company s financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified the critical accounting policies and judgments addressed below. We also have other key accounting policies, which involve the use of estimates, judgments, and assumptions that are significant to understanding our results. For additional information, see Item 1 of Part I, Financial Statements Note 2 Accounting Policies. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions. Our critical accounting policies are as follows:
-revenue recognition;
-estimating valuation allowances and accrued liabilities (specifically, the allowances for returns, credit card chargebacks, doubtful accounts and obsolete and damaged inventory);
-internal use software and website development (acquired and developed internally);
$\bullet$-accounting for income taxes;
$\bullet$ valuation of long-lived and intangible assets and goodwill;
-stock-based compensation; and

- loss contingencies.

Revenue recognition

We derive our revenue primarily from two sources: direct revenue and fulfillment partner revenue, including listing fees and commissions collected from products being listed and sold through the Auctions tab of our Website as well as advertisement revenue derived from our cars and real estate listing business, and from advertising on our shopping pages. We have organized our operations into two principal segments based on the primary source of revenue: Direct revenue and Fulfillment partner revenue.

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured.

Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and, therefore, recognized as revenue at the end of the period. Our delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the shipping carrier (as carriers differ in-transit times); (ii) the fulfillment source (either our warehouses or those of our fulfillment partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment.

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

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The following table shows the effect that hypothetical changes in the estimate of average shipping transit times would have had on the reported amount of revenue and net loss for the three months ended June 30, 2010 (in thousands):

| Change in the <br> Estimate of Average <br> Transit Times (Days) | Three months ended June 30, 2010 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Increase (Decrease) of Revenue |  | Increase (Decrease) of Net Loss |  |
|  |  |  |  |  |
|  |  |  |  |  |
| 2 | \$ | $(5,066)$ | \$ | 902 |
| 1 | \$ | $(2,592)$ | \$ | 456 |
| As reported |  | eported |  | As reported |
| -1 | \$ | 5,015 | \$ | (942) |
| -2 | \$ | 8,689 | \$ | $(1,598)$ |

When we are the primary obligor in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not the primary obligor in the transaction and amounts earned are determined using a fixed percentage, revenue is recorded on a net basis. Currently, the majority of both direct revenue and fulfillment partner revenue is recorded on a gross basis, as we are the primary obligor. In our statements of operations, we present revenue net of sales taxes.

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

## Co-branded credit card revenue

During the six months ended June 30, 2009, we had a co-branded credit card agreement with a third-party bank, for the issuance of credit cards bearing the Overstock brand, under which the bank paid us fees for new accounts, renewed accounts and for card usage. New and renewed account fees were recognized as revenues on a straight-line basis over the estimated life of the credit card relationship. Credit card usage fees were recognized as revenues as actual credit card usage occurs. Our co-branded credit card agreement with the third-party bank terminated effective August 30, 2009.

In March 2010, we entered into a co-branded credit card agreement with a third-party bank for the issuance of credit cards bearing the Overstock.com brand, under which the bank will pay us fees for new accounts and for customer usage of the cards. The agreement also provides for a customer loyalty program offering reward points that customers will accrue from card usage and can use to make purchases on our Website. We have not yet launched the co-branded card, and as such did not earn any revenues from the program during the six months ended June 30, 2010.

## Direct revenue

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Direct revenue is derived from merchandise sales to individual consumers and businesses that are fulfilled from our leased warehouses. Direct revenue comes from sales that occur primarily through our Website, but may also occur through offline channels.

## Fulfillment partner revenue

Fulfillment partner revenue is derived from merchandise sales through our Website which fulfillment partners ship directly to consumers and businesses from warehouses maintained by our fulfillment partners.

We operate an online auction service as a part of our Website. The Auctions business allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. With limited exceptions, we are not considered the seller of the items sold on the auction site and have no control over the pricing of those items. Therefore, for these sales, only the listing fees for items listed and commissions for items sold are recorded as revenue during the period items are listed or items are sold. Revenue from the auctions business is included in the fulfillment partner segment.

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

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We operate an online site for listing real estate for sale as a part of our Website. The real estate listing service allows customers to search active listings across the country. Listing categories include foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Revenue from the real estate listing business has been included in the fulfillment partner segment.

## International business

We began selling products through our website to customers outside the United States in August 2008. As of June 30, 2010, we are offering products to customers in over 90 countries. We do not have operations outside the United States, and are using a U.S. based third party to provide logistics and fulfillment for all international orders. Revenue generated from our international business is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our leased warehouses or from a fulfillment partner.

## Deferred revenue

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

## Sales returns allowance

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

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

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

Total net revenue is recorded net of estimated returns. We record an allowance for returns based on current period revenues and historical returns experience. Management analyzes historical returns, current economic trends and changes in order volume and acceptance of our

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products when evaluating the adequacy of the sales returns allowance in any accounting period. Our actual product returns have not differed materially from our estimates. We are not aware of any trends that we expect would significantly change future returns experience compared to historical experience. The allowance for returns was $\$ 6.3$ million and $\$ 11.9$ million at June 30, 2010 and December 31, 2009, respectively. The decrease in the sales returns reserve at June 30, 2010 compared to December 31, 2009 is primarily due to decreased revenues due to seasonality.

## Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was $\$ 120,000$ and $\$ 139,000$ at June 30, 2010 and December 31, 2009, respectively.

## Allowance for doubtful accounts

From time to time, we grant credit to certain of our business customers on normal credit terms (typically 30 days). We perform credit evaluations of our customers financial condition and payment history and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was $\$ 1.9$ million and $\$ 1.7$ million at June 30, 2010 and December 31, 2009, respectively.

## Valuation of inventories

We write down our inventory for estimated obsolescence and to lower of cost or market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory allowance

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represents the new cost basis of such products. Reversal of the allowance is recognized only when the related inventory has been sold or scrapped. During the three months ended June 30, 2010, we wrote down seasonal inventory that was acquired during the quarter that was not selling as anticipated by approximately $\$ 550,000$.

## Internal-use software and website development

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

## 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 deferred tax assets. As of June 30, 2010 and December 31, 2009, we have recorded a full valuation allowance of $\$ 79.0$ million and $\$ 80.2$ 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.

We are subject to audit by the IRS and various states for periods since inception. Our policy is that we recognize interest and penalties accrued on any unrecognized tax positions as a component of income tax expense. We do not have any material uncertain tax positions, accrued interest or penalties associated with unrecognized tax positions. There have been no material changes relating to these matters during the six months ended June 30, 2010.

We have provided a full valuation allowance on the deferred tax assets, consisting primarily of net operating loss carry-forwards, net of expected reversals of existing deferred tax liabilities, because of uncertainty regarding their realizability.

## Impairment of long-lived assets

We review property and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by comparison of the assets carrying amount to future undiscounted net cash flows the assets are expected to generate. Cash flow forecasts are based on trends of historical performance and management s estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair values. There were no impairments to long-lived assets recorded during the six months ended June 30, 2010, and the year
ended December 31, 2009.

Valuation of goodwill

Goodwill is not amortized, but must be tested for impairment at least annually. In accordance with this guidance, we test for impairment of goodwill in the fourth quarter or when we deem that a triggering event has occurred. Goodwill totaled $\$ 2.8$ million as of June 30, 2010 and December 31, 2009.

There were no impairments to goodwill recorded during the six months ended June 30, 2010 and year ended December 31, 2009.

## Stock options

We measure compensation cost for all outstanding unvested stock-based awards at fair value on date of grant and recognize compensation expense over the service period for awards expected to vest on a straight line basis. The estimation of stock-based 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, and historical experience. Actual results may differ substantially from these estimates. We use the 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 our historical stock prices measured over a period equal to the term of the award.

Expected Term: For 2007 and 2008 option grants, we elected to use the simplified method as discussed in Staff Accounting Bulletin ( SAB ) No. 107, Share Based Payment ( SAB No. 107 ), to develop an estimate of expected term. In

December 2007, the SEC issued SAB No. 110, Certain Assumptions Used in Valuation Methods Expected Term ( SAB No. 110 ). According to SAB No. 110, under certain circumstances the SEC staff will continue to accept the use of the simplified method as discussed in SAB No. 107, in developing an estimate of expected term of plain vanilla share options in accordance with ASC Topic 718, beyond December 31, 2007.

Expected Dividend: We have not paid any dividends and do not anticipate paying dividends in the foreseeable future.

Risk-Free Interest Rate: We base 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, we consider voluntary and involuntary termination behavior and historical experience.

## Restricted stock awards

During the six months ended June 30, 2010, we granted a total of 290,000 restricted stock awards to employees, officers and directors. The restricted stock awards vest over three years at $25 \%$ at the end of the first year, $25 \%$ at the end of the second year and $50 \%$ at the end of the third year, and are subject to the employee s continuing service to us. At June 30, 2010, there were 687,000 un-vested restricted stock awards that remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is recognized on a straight line basis over the three year vesting schedule. The weighted average grant date fair value of restricted stock awards granted during the three and six months ended June 30 , 2010 was $\$ 23.19$ and $\$ 13.04$ per share, respectively.

## Loss contingencies

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

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In January 2010, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2010-06, Improving Disclosures About Fair Value Measurements, which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair- value measurements. ASU 2010-6 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. We do not expect the remaining adoption of ASU 2010-06 related to the reconciliation of Level 3 fair value measurements in 2010 to have a material impact on our consolidated financial statements.

## 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 at the beginning of Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations.

The key factors that impacted 2010 financial results were strong revenue growth, supply chain efficiency gains, and disciplined expense management, particularly for marketing expenditures.

Revenues in Q2 2010 increased by $32 \%$ compared to Q2 2009 revenues. Our pricing and marketing initiatives resulted in revenue growth through new customer growth, higher site traffic, and improved conversion rates. Growth was broadly distributed across each of our major product categories. Our direct business increased by $48 \%$, and our fulfillment partner business increased by $29 \%$ this quarter. During Q2 2010, our direct business was $18 \%$ of total revenue compared to $16 \%$ in Q2 2009. During Q2 2010, our

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fulfillment partner business generated $82 \%$ of our total revenue compared to $84 \%$ in Q2 2009. The average dollar amount of orders placed during the quarter increased from $\$ 118$ in Q2 2009 to $\$ 121$ due to a slight shift in our sales mix toward higher priced items.

While we believe that pricing initiatives had a positive effect on our revenue growth, they had the opposite effect on our gross margin. Q2 2010 gross margin fell by 270 basis points compared to Q2 2009 largely due to our pricing initiatives. We were able to offset part of the gross margin decline and its effect on gross profit through higher revenue growth and supply chain efficiencies. In particular, our costs associated with customer returns for the fulfillment partner business and costs for customer service have decreased as a result of operational improvements and improved business terms.

Marketing expense as a percentage of revenue was $6.1 \%$ of sales for Q2 2010, down from 6.4\% in Q2 2009. We believe that we used relatively effective advertising campaigns and maintained a disciplined approach to marketing expenditures. We believe that our primary focus of increasing contribution (a non-GAAP financial measure described below under Non-GAAP Financial Measures ) has helped improve our marketing efficiency. Our Q2 technology and G\&A expenses increased compared to last year as a result of our investment in corporate and IT staff and infrastructure during Q2 2010, and as a percentage of revenue we saw a 180 basis point improvement over Q2 2009. We plan to continue to make these types of investments.

We retired $\$ 9.3$ million of our Senior Notes during the quarter, using $\$ 9.0$ million of cash. As of June 30, 2010, $\$ 50.3$ million of the Senior Notes remained outstanding.

As shown below under Seasonality, revenues in the second quarter are generally the lowest for the year. However, we do not provide guidance, and any projections of future results are subject to substantial uncertainty.

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.

## Results of Operations

The following table sets forth our results of operations expressed as a percentage of total net revenue:

|  | Three months ended June 30, |  | Six months ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2010 | 2009 | 2010 | 2009 |
|  | (as a percentage of total net revenue) |  | (as a percentage of total net revenue) |  |
| Revenue, net |  |  |  |  |
| Direct | 18.3\% | 16.4\% | 18.8\% | 17.6\% |
| Fulfillment partner | 81.7 | 83.6 | 81.2 | 82.4 |
| Total net revenue | 100.0 | 100.0 | 100.0 | 100.0 |

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| Cost of goods sold |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Direct | 16.2 | 13.5 | 16.3 | 14.9 |
| Fulfillment partner | 65.8 | 65.8 | 65.8 | 65.0 |
| Total cost of goods sold | 82.0 | 79.3 | 82.1 | 79.9 |
| Gross profit | 18.0 | 20.7 | 17.9 | 20.1 |
| Operating expenses: |  |  |  |  |
| Sales and marketing | 6.1 | 6.4 | 5.7 | 6.9 |
| Technology | 6.1 | 7.3 | 5.7 | 7.3 |
| General and administrative | 6.3 | 6.9 | 5.9 | 7.2 |
| Restructuring |  |  |  |  |
| Total operating expenses | 18.5 | 20.6 | 17.3 | 21.4 |
| Operating income (loss) | (0.5) | 0.1 | 0.6 | (1.3) |
| Interest income |  |  |  |  |
| Interest expense | (0.3) | (0.4) | (0.3) | (0.4) |
| Other income, net | 0.3 | 0.5 | 0.2 | 0.7 |
| Income (loss) before taxes | (0.5) | 0.2 | 0.5 | (1.0) |
| Provision (benefit) for income taxes |  |  |  |  |
| Net income (loss) | (0.5)\% | 0.2\% | 0.5\% | (1.0)\% |

## Revenue

Total net revenue increased $32.2 \%$ to $\$ 231.3$ million for the three months ended June 30,2010 , from $\$ 174.9$ million for the three months ended June 30, 2009, due to pricing and marketing initiatives as well as from improvement in the economy in general.

Direct revenue increased $47.8 \%$ to $\$ 42.4$ million for the three months ended June 30,2010 , from $\$ 28.7$ million for the same period in 2009. Fulfillment partner revenue increased $29.2 \%$ to $\$ 188.9$ million for the three months ended June 30,2010 , from $\$ 146.2$ million for the same period in 2009.

Total net revenue increased $37.4 \%$ to $\$ 495.6$ million for the six months ended June 30,2010 , from $\$ 360.6$ million for the six months ended June 30, 2009 due to pricing and marketing initiatives as well as from improvement in the economy in general.

Direct revenue increased $46.2 \%$ to $\$ 93.0$ million for the six months ended June 30, 2010, from $\$ 63.6$ million for the same period in 2009. Fulfillment partner revenue increased $35.5 \%$ to $\$ 402.6$ million for the six months ended June 30, 2010, from $\$ 297.1$ million for the same period in 2009.

The shift of business from Direct to Fulfillment Partner (or vice versa) is an economic decision based on the economics of each particular product offering at the time and we do not have particular goals for appropriate mix or percentages for the size of either. We believe that the mix of the business between Direct and Fulfillment Partner is consistent with our strategic objectives for our business model in the current economic environment and we do not currently foresee any material shifts in mix.

Total revenues from Auctions, Cars and Real Estate businesses were $\$ 661,000$ and $\$ 483,000$ for the three months ended June 30, 2010 and 2009 , respectively and are included in fulfillment partner revenue. For the six months ended June 30, 2010 and 2009, such revenues were $\$ 1.3$ million and $\$ 987,000$, respectively.

Total revenues from International sales were $\$ 2.1$ million and $\$ 757,000$ for the three months ended June 30, 2010 and 2009, respectively and $\$ 4.5$ million and $\$ 1.5$ million for the six months ended June 30, 2010 and 2009 respectively.

See Executive Commentary above for additional discussion regarding revenue and revenue growth.

## Gross profit and gross margin

Our overall gross margins fluctuate based on our sales volume mix between our direct business and fulfillment partner business; changes in vendor and / or customer pricing, including competitive pricing, and inventory management decisions within the direct business; sales coupons and promotions; product mix of sales; and operational and fulfillment costs.

Gross margins for the past five quarterly periods and fiscal year ending 2009 were:

|  | Q1 2009 | Q2 2009 | Q3 2009 | Q4 2009 | FY 2009 | Q1 2010 | Q2 2010 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Direct | $12.9 \%$ | $18.0 \%$ | $11.8 \%$ | $11.9 \%$ | $13.3 \%$ | $13.8 \%$ | $11.7 \%$ |
| Fulfillment Partner | $21.0 \%$ | $21.3 \%$ | $20.7 \%$ | $18.1 \%$ | $19.9 \%$ | $18.8 \%$ | $19.4 \%$ |
| Combined | $19.5 \%$ | $20.7 \%$ | $19.3 \%$ | $17.1 \%$ | $18.8 \%$ | $17.9 \%$ | $18.0 \%$ |

Direct Gross Profit and Gross Margin Gross profit for our direct business decreased $4.0 \%$ to $\$ 4.9$ million for the three months ended June 30, 2010, from $\$ 5.2$ million for the same period in 2009. Gross margin for the direct business decreased to $11.7 \%$ for the three months ended June 30,2010 , from $18.0 \%$ for the same period in 2009. Gross profit for our direct business increased $23.8 \%$ to $\$ 11.9$ million for the three months ended June 30, 2010, from $\$ 9.6$ million for the same period in 2009. Gross margin for the direct business decreased to $12.8 \%$ for the six months ended June 30, 2010, from $15.2 \%$ for the same period in 2009. The decrease in gross margin for the three and six months ended June 30, 2010 is primarily due to pricing initiatives that were implemented beginning in the third quarter of 2009 . Additionally, during the three months ended June 30, 2010, we wrote down seasonal inventory that was acquired during the quarter that was not selling as anticipated by approximately $\$ 550,000$ (See Item 1 of Part I. Financial Statements -Note 2- Accounting Policies - Valuation of inventories ).

Fulfillment Partner Gross Profit and Gross Margin Gross profit for our fulfillment partner business increased $17.7 \%$ to $\$ 36.6$ million for the three months ended June 30, 2010, from $\$ 31.1$ million for the same period in 2009. Gross margin for the fulfillment partner business decreased to $19.4 \%$ for the three months ended June 30, 2010, from $21.3 \%$ for the same period in 2009.

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Gross profit for our fulfillment partner business increased $22.5 \%$ to $\$ 76.9$ million for the six months ended June 30, 2010, compared to $\$ 62.8$ million for the same period in 2009. Gross margin for the fulfillment partner business decreased to $19.1 \%$ for the six months ended June 30, 2010 compared to $21.1 \%$ for the same period in 2009. The decrease in gross margin for the three and six months ended June 30, 2010 is primarily due to decreases in product sales prices from pricing initiatives that were implemented beginning in the third quarter of 2009.

During a review of our partner billing system for returns, we discovered that we had underbilled our fulfillment partners for certain fees and charges related to returns approximately $\$ 1.4$ million for the year ended December 31, 2009 (of which $\$ 237,000$ and $\$ 563,000$ related to the three and six months ended June 30, 2009, respectively) and $\$ 72,000$ and $\$ 359,000$ during the three and six months ended June 30, 2010, respectively. Since our business model is reliant on our relationships with our fulfillment partners and the problem related to an internal record keeping issue on our part, we have made the determination to not seek recovery of these amounts from our fulfillment partners and consequently have not recognized any related recoveries in our consolidated financial statements.

The other factors described above, such as sales coupons and promotions, did not have a significant impact on the change in gross profit.

Cost of goods sold includes stock-based compensation expense of $\$ 53,000$ and $\$ 40,000$ for the three months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010 and 2009, cost of goods sold includes stock-based compensation of $\$ 102,000$ and $\$ 84,000$, respectively.

See Executive Commentary above for additional discussion.

## 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 margin. 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 margin. As a result, our gross margin 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 margin, thus enabling investors to better compare our gross margin with others in our industry (in thousands):

|  |  | Three months ended June 30, |  |  |  |  | Six months endedJune 30, |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2010 |  |  | 2009 |  | 2010 |  |  | 20 |  |
| Total revenue, net | \$ | 231,253 | 100\% | \$ | 174,898 | 100\% \$ | 495,583 | 100\% | \$ | 360,627 | 100\% |
| Cost of goods sold |  |  |  |  |  |  |  |  |  |  |  |
| Product costs and other cost of goods sold |  | 177,153 | 77\% |  | 128,898 | 73\% | 380,027 | 77\% |  | 267,464 | 74\% |

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| Fulfillment costs | 12,521 | $5 \%$ | 9,713 | $6 \%$ | 26,706 | $5 \%$ | 20,745 | $5 \%$ |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Total cost of goods sold | 189,674 | $82 \%$ | 138,611 | $79 \%$ | 406,733 | $82 \%$ | 288,209 | 8 | $80 \%$ |
| Gross profit | $\$$ | 41,579 | $18 \%$ | $\$$ | 36,287 | $21 \%$ | $\$$ | 88,850 | $18 \%$ |

As displayed in the above table, fulfillment costs during the three months ended June 30, 2010 and 2009 were $\$ 12.5$ million and $\$ 9.7$ million, representing $5 \%$ and $6 \%$ of total net revenue for those respective periods. For the six months ended June 30, 2010 and 2009, fulfillment costs were $\$ 26.7$ million and $\$ 20.7$ million, representing $5 \%$ and $6 \%$ of total net 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 to which we use third party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees.

## Operating expenses

Sales and marketing expenses. We direct customers to our Website 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 use nationwide television, print and radio advertising campaigns to promote sales.

Sales and marketing expenses totaled $\$ 14.2$ million and $\$ 11.2$ million for the three months ended June 30, 2010 and 2009, respectively, representing $6.1 \%$ and $6.4 \%$ of total net revenue for those respective periods. For the six months ended June 30, 2010 and 2009, sales and marketing expenses totaled $\$ 28.5$ million and $\$ 24.7$ million, respectively, representing $5.7 \%$ and $6.9 \%$ of total net revenue for those respective periods. The decrease in sales and marketing costs as a percentage of revenue for the three and six months

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ended June 30, 2010 was primarily due to more efficient marketing spending. We were able to generate more revenue per dollar of marketing spent in 2010.

Sales and marketing expenses include stock-based compensation expense of $\$ 153,000$ and $\$ 161,000$ for the three months ended June 30,2010 and 2009, respectively. For the six months ended June 30, 2010 and 2009, sales and marking expenses include stock-based compensation expense of $\$ 303,000$ and $\$ 303,000$, respectively.

Costs associated with our discounted shipping and other promotions are not included in marketing expense. Rather they are accounted for as a reduction of total net revenue and therefore affect sales growth and gross margin. We consider discounted shipping and other promotions as an effective marketing tool, and intend to continue to offer them as we deem appropriate as part of our overall marketing plan.

Technology expenses. We seek to efficiently invest in our technology, including web services, customer support, search, and expansion of new and existing product categories, as well as technology infrastructure to continue to enhance the customer experience, improve our process efficiency and support our web services infrastructure.

Technology expenses totaled $\$ 14.2$ million and $\$ 12.7$ million for the three months ended June 30, 2010 and 2009, respectively, representing $6.1 \%$ and $7.3 \%$ of total net revenue for those respective periods. The $\$ 1.5$ million increase is primarily due to a $\$ 1.1$ million increase in compensation expense primarily due to increases in staffing.

For the six months ended June 30, 2010 and 2009, technology expenses totaled $\$ 28.1$ million and $\$ 26.3$ million, respectively, representing $5.7 \%$ and $7.3 \%$ of total revenue for those respective periods. The $\$ 1.8$ million increase is primarily due to a $\$ 2.7$ million increase in compensation expense (primarily due to increases in staffing), partially offset by $\$ 875,000$ of decrease in other technology expenses including depreciation expense.

Technology expenses include stock-based compensation expense of $\$ 271,000$ and $\$ 235,000$ for the three months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010 and 2009, technology expenses include stock-based compensation expense of $\$ 522,000$ and $\$ 471,000$, respectively.

General and administrative expenses. General and administrative (G\&A ) expenses totaled $\$ 14.5$ million and $\$ 12.3$ million for the three months ended June 30, 2010 and 2009, respectively, representing approximately $6.3 \%$ and $6.9 \%$ of total net revenue for those respective periods. The $\$ 2.2$ million increase is due to a $\$ 1.0$ million increase in compensation expense primarily due to increases in staffing, and higher legal fees resulting from a $\$ 600,000$ reduction in legal expenses in 2009 related to payments received from the settlement of legal matters.

For the six months ended June 30, 2010 and 2009 respectively, G\&A expenses totaled $\$ 29.4$ million and $\$ 26.2$ million representing approximately $5.9 \%$ and $7.2 \%$ of total net revenue for those respective periods. The $\$ 3.2$ million increase is primarily due to an increase in professional service fees for our external auditors, and higher legal fees resulting from a $\$ 1.2$ million reduction in legal expenses in 2009 related to payments received from the settlement of legal matters.

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General and administrative expenses include stock-based compensation expense of approximately $\$ 793,000$ and $\$ 729,000$ for the three months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010 and 2009, G\&A expenses include stock-based compensation expense of $\$ 1.6$ million and $\$ 1.5$ million, respectively.

Restructuring. There were no restructuring charges during the three months ended June 30, 2010. We reversed $\$ 136,000$ of lease termination costs liability during the six months ended June 30, 2010 due to changes in our estimate of sublease income, primarily as a result of our entering into an agreement with a sublessee to terminate the sublease and have us re-occupy a portion of the space previously abandoned, due to our growth and need for additional space. During the three and six months ended June 30,2009 , we reversed $\$ 66,000$ of lease termination costs liability due to changes in our estimate of sublease income, primarily as a result of entering into a sublease agreement for previously vacant space.

Overall, our total operating expenses increased $18.6 \%$ during the three months ended June 30, 2010 when compared to the same period in 2009, while total net revenues increased $32.2 \%$ and gross profit increased $14.6 \%$. During the six months ended June 30 , 2010, our total operating expenses increased $11.3 \%$ while total net revenues increased $37.4 \%$ and gross profit increased $22.7 \%$.

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

|  | Three months ended June 30, |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  | 2009 |  | 2010 |  | 2009 |  |
| Cost of goods sold - direct | \$ | 297 | \$ | 322 | \$ | 636 | \$ | 645 |
| Sales and marketing |  |  |  |  |  |  |  |  |
| Technology |  | 3,051 |  | 2,555 |  | 5,634 |  | 6,049 |
| General and administrative |  | 204 |  | 169 |  | 376 |  | 339 |
| Total depreciation and amortization, including internal-use software and website development | \$ | 3,552 | \$ | 3,046 | \$ | 6,646 | \$ | 7,033 |

## Non-operating income (expense)

Interest income. Interest income is primarily derived from the investment of our cash in short-term investments. Interest income for the three months ended June 30, 2010 and 2009 totaled $\$ 40,000$ and $\$ 27,000$, respectively. For the six months ended June 30 , 2010 and 2009, interest income totaled $\$ 56,000$ and $\$ 150,000$, respectively. The decreases in interest income are primarily due to historically low interest rates.

Interest expense. Interest expense is largely related to interest incurred on our Senior Notes and our capital leases. Interest expense for the three months ended June 30, 2010 and 2009 totaled $\$ 760,000$ and $\$ 808,000$, respectively. For the six months ended June 30 , 2010 and 2009 , interest expense totaled $\$ 1.6$ million and $\$ 1.7$ million, respectively.

Other income, net. Other income, net for the three months ended June 30, 2010 and 2009 totaled $\$ 652,000$ and $\$ 954,000$, respectively. For the six months ended June 30, 2010 and 2009, other income, net totaled $\$ 1.0$ million and $\$ 2.7$ million, respectively. The decrease in other income, net was primarily due to lower gains on extinguishment of long-term debt during the six months ended June 30 , 2010 when compared to the same period in 2009 . For the three and six months ended June 30,2010 , we retired a total of $\$ 9.3$ million of our Senior Notes for $\$ 9.0$ million in cash, resulting in a gain of $\$ 204,000$ on early extinguishment of debt, net of $\$ 66,000$ of associated unamortized discount. For the three months ended June 30, 2009, we retired $\$ 2.5$ million of our Senior Notes for $\$ 1.6$ million in cash, resulting in a gain of $\$ 884,000$ on early extinguishment of debt, net of $\$ 29,000$ of associated unamortized discount. For the six months ended June 30 , 2009 , we retired $\$ 7.4$ million of Senior Notes for $\$ 4.6$ million in cash, resulting in a gain of $\$ 2.8$ million on early extinguishment of debt, net of $\$ 92,000$ of associated unamortized discount.

## Income taxes

Our provision (benefit) for income taxes for the three months and six months ended June 30,2010 of $\$(7,000)$ and 122,000 is for federal alternative minimum tax and certain income tax uncertainties, including interest and penalties. As of June 30, 2010 and December 31, 2009 we had federal net operating loss carry forwards of approximately $\$ 159.3$ million and $\$ 160.4$ million, respectively, and state net operating loss carry forwards of approximately $\$ 139.0$ million and $\$ 140.1$ million, respectively, which may be used to offset future taxable income. An additional $\$ 15.9$ million of net operating losses ( NOLs ), related to the acquisition of Gear.com, are limited under Internal Revenue Code Section 382 to

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$\$ 799,000$ a year plus any excess over limitations not utilized in prior years. The annual limitation available in a given year for NOLs subject to IRC Section 382 is the product of the Company s value on the date of ownership change and the federal long-term tax-exempt rate. These net operating loss carry-forwards will begin to expire in 2018.

## Seasonality

Based upon our historical experience, revenues typically increase during the fourth quarter because of the holiday 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 second half revenues will exceed first half revenues, or that seasonal variations will not materially affect our results of operations in the future. The following table reflects our total net revenues for each of the quarters since 2007 (in thousands):

|  | First <br> Quarter |  | Second <br> Quarter | Third <br> Quarter | Fourth <br> Quarter |
| ---: | :---: | :---: | :---: | ---: | ---: |
| 2010 | $\$$ | 264,330 | 231,253 | N/A | N/A |
| 2009 | 185,729 | 174,898 | 193,783 | 322,359 |  |
| 2008 | 201,800 | 188,202 | 186,007 | 253,841 |  |
| 2007 | 162,156 | 149,171 | 160,059 | 294,516 |  |

## Liquidity and Capital Resources

## Historical sources of liquidity

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 $3.75 \%$ Convertible Senior Notes due 2011 in a transaction exempt from registration under the Securities Act. During 2006, we received $\$ 64.4$ million from two stock offerings in May and December.

## Current sources of liquidity

While we believe that the cash and cash equivalents currently on hand 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, profits or to 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.

Our principal sources of liquidity are cash flows generated from annual operations and our existing cash and cash equivalents resources. At June 30, 2010, our cash and cash equivalents balance was $\$ 76.0$ million.

Cash flow information is as follows:

|  | $\begin{array}{c}\text { Six months ended } \\ \text { June 30, }\end{array}$ |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Cash provided by (used in): | $\mathbf{2 0 1 0}$ | $\mathbf{2 0 0 9}$ |  |
| (in thousands) |  |  |  |$]$

Free Cash Flow. Free Cash Flow (a non-GAAP measure) for the six months ended June 30, 2010 and 2009, was cash outflows of $\$ 54.8$ million and $\$ 35.8$ million, respectively. See Non-GAAP Financial Measures below for a reconciliation of Free Cash Flow to net cash used in operating activities.

Cash flows from operating activities. Cash received from customers generally corresponds to our net sales as our customers primarily use credit cards to buy from us causing our receivables from these sales transactions to settle quickly. We have payment terms with our fulfillment partners that generally extend beyond the amount of time necessary to collect proceeds from our customers. As a result, following our typically seasonally strong fourth quarter sales, at December 31 of each year, our cash and cash equivalents, 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 and cash equivalents balance from the year-end balance.

Operating activities resulted in net cash outflows of $\$ 39.9$ million and $\$ 32.3$ million for the six months ended June 30, 2010 and 2009, respectively. The primary operating use of cash and cash equivalents during the six months ended June 30, 2010 was for payments of accounts payable and accrued liabilities of $\$ 36.4$ million and $\$ 15.0$ million following the holiday season, which was partially offset by the cash from collection of accounts receivable of $\$ 3.4$ million.

During the six months ended June 30, 2010, our credit card processor refunded the full $\$ 1$ million reserve that it previously held at December 31, 2009. The credit card processor may change the amount of this reserve at any time based on its assessment of the inherent risks of credit card processing and its assessment of the risks of processing our customers credit cards. Any increase in the amount of the reserve established by the processor could have an adverse effect on our cash flow, and any material unexpected increase could have a material adverse effect on our liquidity, business, prospects, results of operations and financial condition.

For the six months ended June 30, 2009, the $\$ 32.3$ million of net cash used in operating activities was attributable to payments accounts payable and accrued liabilities of $\$ 33.6$ million and $\$ 2.9$ million following the holiday season. Additionally, $\$ 2.7$ million of cash from sales in the first six months of 2009 were held in reserve by our credit card processor. Other cash used in

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operating activities for the six month period ended June 30,2009 , related to prepayments of $\$ 2.6$ million related to software maintenance agreements and payments on prepaid inventory of $\$ 1.1$ million. The amount of cash used in operating activities for the six months ended June 30, 2009 was partially offset by cash from sales of inventories exceeding purchases of inventory by $\$ 8.6$ million due to the lower seasonal inventory levels required to support a lower seasonal level of sales in the first half of the year.

Cash flows from investing activities. For the six months ended June 30, 2010 and 2009, investing activities resulted in net cash outflows of $\$ 15.0$ million and net cash inflows of $\$ 6.6$ million, respectively. The $\$ 15.0$ million used in investing activities during the six months ended June 30 , 2010 resulted primarily from expenditures for fixed assets of $\$ 14.8$ million, which largely consisted of software and hardware purchases for our data warehouse and other data storage infrastructure in order to support our growth. The $\$ 6.6$ million of net cash provided by investing activities during the six months ended June 30,2009 was primarily from the sale of marketable securities of $\$ 8.9$ million and the collection of a $\$ 1.3$ million note receivable related to a settlement of notes from the sale of our travel subsidiary to Castles Travel, partially offset by capital expenditures of $\$ 3.5$ million.

Cash flows from financing activities. For the six months ended June 30, 2010 and 2009, financing activities resulted in net cash outflows of $\$ 8.8$ million and $\$ 5.2$ million, respectively, which resulted primarily from $\$ 9.0$ million and $\$ 4.6$ million used for retirement of long-term debt, respectively.

## Stock and Debt Repurchase Program

On February 17, 2009, the Board of Directors approved a debt repurchase program that authorizes us to use up to $\$ 20.0$ million in cash to repurchase a portion of our Senior Notes. Under this repurchase program, we retired $\$ 9.3$ million of the Senior Notes during the six months ended June 30, 2010 for $\$ 9.0$ million in cash, resulting in a gain of $\$ 204,000$ on early extinguishment of debt, net of $\$ 66,000$ of associated unamortized discount at an approximate $5.7 \%$ yield to maturity. We retired $\$ 7.4$ million of the Senior Notes during the six months ended June 30, 2009 for $\$ 4.6$ million in cash, resulting in a gain of $\$ 2.8$ on early extinguishment of debt, net of $\$ 92,000$ of associated unamortized discount at an approximate $22.6 \%$ yield to maturity. As of June 30, 2010 and December 31, 2009, $\$ 50.3$ million and $\$ 59.5$ million of the Senior Notes remained outstanding, respectively.

During the three months ended June 30, 2010 and 2009, we withheld from vesting restricted stock awards totaling approximately 1,000 and 645 shares of our common stock for $\$ 26,000$ and $\$ 7,000$, respectively. During the six months ended June 30, 2010 and 2009, we withheld from vesting restricted stock awards totaling approximately 63,000 and 36,000 shares of our common stock for $\$ 818,000$ and $\$ 334,000$, respectively. The shares withheld represented the minimum tax withholdings upon the vesting of those restricted stock award grants to satisfy the minimum tax withholdings owed by the grantee of the restricted stock award grant. None of these shares were repurchased in the open market.

## Redeemable Common Stock

In June 2009, we discovered that we inadvertently issued 203,737 more shares of our common stock in connection with our 401(k) plan than had been registered with the Securities and Exchange Commission for offer in connection with the $401(\mathrm{k})$ plan. These shares were contributed to or otherwise acquired by participants in the $401(\mathrm{k})$ plan between August 16, 2006, and June 17, 2009. As a result, certain participants in the 401(k) plan may have or have had rescission rights relating to the unregistered shares, although we believe that the federal statute of limitations

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applicable to any such rescission rights would be one year, and that the statute of limitations had already expired at September 30, 2009 with respect to most of the inadvertent issuances. At June 30, 2010 and December 31, 2009, approximately 65,000 shares or $\$ 821,000$ and 65,000 shares or $\$ 744,000$, respectively, of our common stock including interest were classified outside stockholders equity because of the potential rescission rights.

On August 31, 2009, we entered into a Tolling and Standstill Agreement (the Agreement ) with the Overstock.com, Inc. Employee Benefits Committee (the Committee ) relating to the Overstock.com, Inc. 401(k) plan (the Plan ). We entered into the Agreement in order to preserve certain rights, if any, of Plan participants who acquired shares of Overstock common stock in the Plan between July 1, 2008 and June 30, 2009. We intend to make a rescission offer to affected participants in the Plan who acquired shares of Overstock common stock between July 1, 2008 and June 30, 2009, subject to compliance with applicable regulatory matters.

Based on the closing price of Overstock common stock of $\$ 18.07$ at June 30, 2010, we anticipate that of the $\$ 821,000$ of affected stock outstanding as of June 30, 2010, it would be uneconomical for participants to attempt to rescind their acquisitions of more than $\$ 155,000$ of the stock which represents the dollar amount of common stock that was acquired by the participants at a per share price greater than $\$ 18.07$ and therefore these purchasers are the ones more likely to accept the offer. The actual amount of our potential liability will be determined based on our closing stock price on the date of expiration of the rescission offer, as under the anticipated terms of the rescission offer we will not repurchase shares if the amount paid by participants for the shares, plus interest, is less than our closing stock price on the date of the expiration of the rescission offer (as such participants would be in a position of having an unrealized gain, not a loss). The following table discloses the aggregate potential liability based on a range of hypothetical closing prices of our common stock:

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| Closing <br> Stock Price |  |  | Aggregate Potential <br> Liability |
| :--- | ---: | :--- | ---: |
| $\$$ | 7.50 | $\$$ |  |
| $\$$ | 10.00 | $\$$ |  |
| $\$$ | 12.50 | $\$$ |  |
| $\$$ | 15.00 | $\$$ |  |
| $\$$ | 17.50 | $\$$ |  |
| $\$$ | 20.00 | $\$$ |  |
| $\$$ | 22.50 | $\$$ | 192,000 |
| $\$$ | 25.00 | $\$$ | 154,977 |

## Contractual Obligations and Commitments

The following table summarizes our contractual obligations as of June 30, 2010 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods (in thousands):


## Amounts of Commitment Expiration Per Period

| Other Commercial Commitments | 2010 |  | 2011 |  | 2012 | 2013 | 2014 | Thereafter | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Letters of credit | \$ | 2,580 | \$ | 250 | \$ | \$ | \$ | \$ | \$ | 2,830 |

Purchase obligations. The amount of purchase obligations shown above is based on assumptions regarding the legal enforceability against us of purchase orders we had outstanding at June 30, 2010. 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

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The Financing Agreement provides for revolving loans and other financial accommodations to or for the benefit of the Company of (i) up to $\$ 10$ million for cash-collateralized advances, and (ii) up to $\$ 10$ million for advances supported by the Company s non-cash collateral. The maximum credit potentially available under the revolving facility is $\$ 20$ million. Our obligations under the Financing Agreement and all related agreements are secured by all or substantially all of our assets, excluding our interest in certain litigation. Subject to certain exceptions, the full amount of the revolving facility is expected to be available to us as long as $\$ 20$ million is maintained on deposit with U.S. Bank. The obligation of U.S. Bank to make advances under the Financing Agreement is subject to the conditions set forth in the Financing Agreement.

Our failure to keep at least $\$ 20$ million on deposit in certain accounts with U.S. Bank would constitute a triggering event under the Financing Agreement. If a triggering event occurs, we would become subject to financial covenants (i) limiting our capital expenditures to $\$ 20$ million annually, and (ii) requiring us to maintain a fixed charges coverage ratio of at least 1.10 to 1.00 as of the end of any fiscal quarter for the period of the prior four quarters. The occurrence of a triggering event could also result in a decrease in the amount available to us under the non cash-collateralized portion of the facility, as availability would then depend, in part, on the Borrowing Base (as defined in the Financing Agreement). The Financing Agreement and the credit facility terminate on October 2, 2011. As of June 30, 2010, we had $\$ 20.0$ million in compensating cash balances held at U.S. Bank.

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Subject to certain interest rate floors and other exceptions, advances under the Financing Agreement bear interest at either (a) Libor plus $1 \%$ for cash-collateralized financing, including letters of credit, or (b) Libor plus $2.5 \%$ for non cash- collateralized advances. The default rate of interest is $2.0 \%$ per annum over the otherwise applicable interest rate. An unused line fee of $0.375 \%$ is payable monthly on the unused portion of the $\$ 10$ million facility available for non cash-collateralized advances.

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

With certain exceptions, a termination fee of up to $1.0 \%$ of the non cash-collateralized portion of the facility is payable by us if we terminate the facility prior to its stated termination date.

No amounts were outstanding under the Financing Agreement at June 30, 2010 and December 31, 2009, and letters of credit totaling $\$ 2.8$ million and $\$ 2.6$ million, respectively, were issued on our behalf and collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets.
U.S. Bank Purchasing Card Agreement. On December 16, 2009, we entered into a commercial purchasing card agreement (the Purchasing Card ) with U.S. Bank National Association. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At June 30, 2010, $\$ 2.1$ million was outstanding and $\$ 2.9$ million was available under the Purchasing Card. At December 31, 2009, no amount was outstanding and $\$ 5.0$ million was available under the Purchasing Card.

Long-Term debt arrangements and interest. In November 2004, we completed an offering of $\$ 120.0$ million of $3.75 \%$ Convertible Senior Notes due 2011 ( Senior Notes ). Proceeds to us were $\$ 16.2$ 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 effective interest method. We recorded amortization of discount and debt issuance costs related to this offering totaling $\$ 66,000$ and $\$ 71,000$ during the three months ended June 30, 2010 and 2009, respectively and $\$ 134,000$ and $\$ 144,000$ during the six months ended June 30, 2010 and 2009, respectively. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

The Senior Notes are convertible at any time prior to maturity into our common stock at the option of the note holders at a conversion price of $\$ 76.23$ per share or, approximately 665,000 shares in aggregate (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 ownership). We have the right to redeem the

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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 us, certain changes in our 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.

At present we do not have any plan to redeem the outstanding Senior Notes in accordance with their redemption provisions but we may acquire additional Senior Notes in future open market purchases. To the extent the Senior Notes remain outstanding at maturity, we intend to pay them at maturity either with proceeds from operations or from financing activities.

The indenture governing the Senior Notes requires us 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. Wilmington Trust Company currently serves as Trustee under the indenture.

On February 17, 2009, our Board of Directors approved a debt repurchase program that authorizes us to use up to $\$ 20.0$ million in cash to repurchase a portion of our Senior Notes. Under the repurchase program, we retired $\$ 9.3$ million of the Senior Notes during the six months ended June 30, 2010 for $\$ 9.0$ million in cash, resulting in a gain of $\$ 204,000$ on early extinguishment of debt, net of $\$ 66,000$ of associated unamortized discount. We retired $\$ 7.4$ million of the Senior Notes during the six months ended June 30,

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2009 for $\$ 4.6$ million in cash, resulting in a gain of $\$ 2.8$ million on early extinguishment of debt, net of $\$ 92,000$ of associated unamortized discount. As of June 30, 2010 and December 31, 2009, $\$ 50.3$ million and $\$ 59.5$ million of the Senior Notes remained outstanding, respectively.

## 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 our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that would be material to investors other than disclosed in the table above.

## Non-GAAP Financial Measures

Regulation G, Conditions for Use of Non-GAAP Financial Measures, and other SEC regulations regulate the disclosure of certain non-GAAP financial information.

Contribution and Contribution Margin. Contribution (a non-GAAP financial measure) (which we reconcile to Gross profit in our statement of operations) consists of gross profit less sales and marketing expense and reflects an additional way of viewing our results. Contribution Margin is Contribution as a percentage of revenues. When viewed with our GAAP gross profit less sales and marketing expenses, we believe Contribution and Contribution margin provides management and users of the financial statements information about our ability to cover our fixed operating costs, such as technology and general and administrative expenses. Contribution and Contribution Margin are used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial measures. You should review our financial statements and publicly-filed reports in their entirety and not rely on any single financial measure. The material limitation associated with the use of Contribution is that it is an incomplete measure of profitability as it does not include all operating expenses or non-operating income and expenses. Management compensates for these limitations when using this measure by looking at other GAAP measures, such as operating income (loss) and net income (loss). For further details on Contribution, see the calculation of this non-GAAP measure below (in thousands):

|  | Three months ended June 30, |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2010 |  | 2009 |  | 2010 |  | 2009 |
| Total revenue, net | \$ | 231,253 | \$ | 174,898 | \$ | 495,583 | \$ | 360,627 |
| Cost of goods sold |  | 189,674 |  | 138,611 |  | 406,733 |  | 288,209 |
| Gross profit |  | 41,579 |  | 36,287 |  | 88,850 |  | 72,418 |
| Less: Sales and marketing expense |  | 14,179 |  | 11,162 |  | 28,458 |  | 24,749 |
| Contribution | \$ | 27,400 | \$ | 25,125 | \$ | 60,392 | \$ | 47,669 |
| Contribution margin |  | 11.8\% |  | 14.4\% |  | 12.2\% |  | 13.2\% |

Free Cash Flow. Free cash flow (a non-GAAP financial measure) reflects an additional way of viewing our cash flows and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our cash flows and liquidity. Free cash flow, which we reconcile to Net cash provided by (used in) operating activities , is cash flows from operations reduced by Expenditures for fixed assets, including internal-use software and website development. We believe that cash flows from operating activities is an important measure, since it includes both the cash impact of the continuing operations of the business and changes in the balance sheet that impact cash. However,

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we believe free cash flow is a useful measure to evaluate our business since purchases of fixed assets are a necessary component of ongoing operations and free cash flow measures the amount of cash we have available for future investment, debt retirement or other changes to our capital structure after we have paid all of our expenses. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows as calculated below (in thousands):

|  | 2010 Six m |  | end |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  |  | 2009 |  |
| Net cash used in operating activities | \$ | $(39,938)$ | \$ | $(32,285)$ |
| Expenditures for fixed assets, including internal-use software and website development |  | $(14,827)$ |  | $(3,523)$ |
| Free cash flow | \$ | $(54,765)$ | \$ | $(35,808)$ |

## 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

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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. Some states impose on us the obligation to notify our customers of use tax obligations, and impose on us reporting requirements. These taxes, tax initiatives, and tax notice and reporting requirements could have an adverse effect on our cash flows, the volume of our business 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, and all other information in this Form 10-Q and in our other filings with the SEC including those we file after we file this Form $10-\mathrm{Q}$, 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 under Risk Factors in our most recent Annual Report on Form 10-K or herein 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, trade accounts and contracts receivable, accounts payable and long-term obligations. We consider investments in highly-liquid instruments with a remaining maturity of three months 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. However, the fair values of our investments may be subject to fluctuations due to volatility of the stock market in general, investment-specific circumstances, and changes in general economic conditions.

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At June 30, 2010, we had $\$ 76.0$ million in cash and cash equivalents. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated annual impact of $\$ 760,000$ on our earnings or loss or cash flows of these instruments.

At June 30, 2010, we had $\$ 50.3$ million of $3.75 \%$ Convertible Senior Notes due 2011 ( Senior Notes ) outstanding which bear interest at a fixed rate of $3.75 \%$. At June 30, 2010, there were no borrowings outstanding under our lines of credit, and letters of credit totaling $\$ 2.8$ million were outstanding under our credit facilities.

The fair value of the Senior Notes is sensitive to interest rate changes. Interest rate changes would result in increases or decreases in the fair value of the 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 Senior Notes in the open market, changes in the fair value of Senior Notes have no impact on our cash flows or consolidated financial statements. The estimated fair value of our $3.75 \%$ Senior Notes as of June 30, 2010 was $\$ 45.9$ million. The fair value of the Senior Notes was derived using a convertible debt pricing model with observable market inputs, which include stock price, dividend payments, borrowing costs, equity volatility, interest rates and interest spread.

## ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Act or Exchange Act ). The term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act ( 15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission s rules
and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

## Evaluation of Disclosure Controls and Procedures

We 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 and Risk Management (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 June 30, 2010. Based on this evaluation, the Chief Executive Officer (principal executive officer) and Senior Vice President, Finance (principal financial officer) concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this Quarterly Report on Form $10-\mathrm{Q}$ due to the following material weaknesses:

- We lacked a sufficient number of accounting professionals with the necessary knowledge, experience and training to adequately account for and perform adequate supervisory reviews of significant transactions that resulted in misapplications of GAAP.
- Information technology program change and program development controls were inadequately designed to prevent changes in our accounting systems which led to the failure to appropriately capture and process data.


## Changes in Internal Control Over Financial Reporting

During the quarter ended June 30, 2010, we implemented the following changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting:

- We have hired additional accounting professionals.
- We have reorganized our accounting and financial reporting department to improve supervisory review.
- We have hired additional professionals for our internal audit department.
- We have reorganized our supply chain department to provide comprehensive oversight over our returns process and partner billing accuracy.
- We engaged a consulting firm to evaluate our information systems. The consulting firm completed its review of our information systems during the second quarter of 2010 and, as described below, we are in the process of implementing the changes recommended by the consulting firm.

Although management believes our internal control over financial reporting has been, or is reasonably likely to be, materially and positively affected by the changes described above, material weaknesses in our internal control over financial reporting continue to exist at June 30, 2010. We are still in the process of enacting additional changes to remediate these material weaknesses, and are in the process of implementing the following changes in our internal control over financial reporting:

- We are in the process of implementing improvements to our information systems recommended by the consulting firm mentioned above, such as 1) evaluation of third party tools for possible automation of order-to-cash reconciliations, 2)initiation of a formal review process by finance personnel to determine potential financial reporting implications of proposed information system development projects, and 3)initiation of a formal post-implementation review process for deployed information system development projects to confirm that changes are working as intended.
- We are in the process of reviewing our systems and controls to provide assurance that they appropriately capture amounts to be paid to fulfillment partners or deducted from partner payments.
- We are in the process of enhancing our information systems testing to improve the completeness and accuracy of data provided by our information systems.


## PART II. OTHER INFORMATION

## ITEM 1.

## LEGAL PROCEEDINGS

The information set forth under Item 1 of Part I, Financial Statements Note 6 Commitments and Contingencies, subheading Legal Proceedings, contained in the Notes to Consolidated Financial Statements of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this Item.

## ITEM 1A.

## RISK FACTORS

Item 1A, ( Risk Factors ) of our most recently filed Form 10-K sets forth information relating to important risks and uncertainties that could materially affect our business, financial condition or operating results. There have been no material changes from the Risk Factors described in our Annual Report on Form 10-K; however, those Risk Factors continue to be relevant to an understanding of our business, financial condition and operating results and, accordingly, you should review and consider such Risk Factors in making any investment decision with respect to our securities. An investment in our securities continues to involve a high degree of risk.

## Available Information

Our Internet website address is http://www.overstock.com or http://investors.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. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The address of that site is http://www.sec.gov. Our Internet website and the information contained therein or connected thereto are not a part of or incorporated into this Quarterly Report on Form $10-\mathrm{Q}$ or any other filings.

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

The following table sets forth all purchases made by or on behalf of the Company or any affiliated purchaser as defined in Rule 10b-18(a)(3) under the Exchange Act, of shares of the Company s common stock made during each month within the second quarter of 2010, including all purchases made pursuant to publicly announced plans or programs and those not made pursuant to publicly announced plans or programs. Column (a) sets forth the total number of shares purchased, and the footnotes to the table disclose the number of shares purchased other than pursuant to a publicly announced plan or program and the nature of any such purchases. Column (b) sets forth the average price paid per share. Column (c) sets forth the total number of shares purchased as part of publicly announced repurchase plans or programs. Column (d) sets forth the maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs.

The footnotes to the table indicate the date each plan or program was announced, the dollar amount or share amount approved, the expiration date, if any, of each plan or program, each plan or program that has expired during the period covered by the table, and each plan or program the Company has determined to terminate prior to expiration, or under which the Company does not intend to make further purchases.

| (a) Total Number of |  |
| :---: | :---: | :---: |
| Shares (or Units) |  |
| Purchased | (b) Average Price <br> Paid per Share or <br> Unit |

(a) Total Number of Purchased
(b) Average Price Unit
(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs
(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs

April 1, 2010 to April 30,

| 2010 | \$ |  |  | \$ |
| :---: | :---: | :---: | :---: | :---: |
| May 1, 2010 to May 31, |  |  |  |  |
| 2010 | 1,139 | \$ | 21.53 | \$ |
| June 1, 2010 to June 30, |  |  |  |  |
| Total | 1,139 | \$ |  | \$ |

(1) Represents shares withheld for minimum tax withholdings upon the vesting of a portion of certain restricted stock award grants. No shares were repurchased in the open market.

## ITEM 3.

DEFAULTS UPON SENIOR SECURITIES

## None.

## ITEM 4.

(REMOVED AND RESERVED)

## ITEM 5.

OTHER INFORMATION

None.

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## ITEM 6.

EXHIBITS
(a) Exhibits
31.1 Exhibit 31.1 Certification of Chief Executive Officer
31.2 Exhibit 31.2 Certification of Chief Financial Officer
32.1 Exhibit 32.1 Section 1350 Certification of Chief Executive Officer
32.2 Exhibit 32.2 Section 1350 Certification of Chief Financial Officer

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## 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/ Stephen J. Chesnut
Stephen J. Chesnut
Senior Vice President, Finance and Risk Management


[^0]:    U.S. Bank Financing Agreement. On December 23, 2009 we entered into (i) a Financing Agreement dated December 22, 2009 (the Financing Agreement ) with U.S. Bank National Association ( U.S. Bank ), and (ii) a Security Agreement dated December 22, 2009 with U.S. Bank (the Security Agreement ) and related agreements described in the Financing Agreement and/or Security Agreement.

