OVERSTOCK.COM, INC
Form 10-Q
November 10, 2008
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended September 30, 2008
	Or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

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

6350 South 3000 East

Salt Lake City, Utah 84121

(Address, including zip code, of

Registrant s principal executive offices)

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

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

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	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 22,745,002 shares of the Registrant s common stock, par value $0.0001, outstanding on November 4, 2008.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets (unaudited)

(in thousands)

	December 31, 2007 (Restated)	September 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 101,394	$ 43,525
Marketable securities	46,000	26,938
Cash, cash equivalents and marketable securities	147,394	70,463
Accounts receivable, net	11,208	10,081
Notes receivable (Note 5)	1,506	
Inventories, net	25,643	17,481
Prepaid inventory	3,572	4,552
Prepaid expenses	7,572	10,935
Total current assets	196,895	113,512
Property and equipment, net	27,197	24,552
Goodwill	2,784	2,784
Other long-term assets, net	86	25
Notes receivable (Note 5)	4,181	4,589
Total assets	$ 231,143	$ 145,462
Liabilities and Stockholders Equity (Deficit)		
Current liabilities:		
Accounts payable	$ 70,358	$ 34,659
Accrued liabilities	37,155	25,631
Deferred revenue	22,965	19,730
Capital lease obligations	3,796	
Total current liabilities	134,274	80,020
Other long-term liabilities	3,034	2,642
Convertible senior notes	75,623	66,481
Total liabilities	212,931	149,143
Commitments and contingencies (Notes 8 and 9)		
Stockholders equity (deficit):		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2007 and September 30, 2008		
Common stock, $0.0001 par value, 100,000 shares authorized, 25,423 and 25,538 shares issued as of December 31, 2007 and September 30, 2008, respectively	2	2
Additional paid-in capital	333,909	339,062
Accumulated deficit	(252,327)	(265,999)
Treasury stock, 1,605 and 2,793 shares at cost as of December 31, 2007 and September 30, 2008, respectively	(63,278)	(76,670)

Accumulated other comprehensive loss		(94)		(76)
Total stockholders equity (deficit)		18,212		(3,681)
Total liabilities and stockholders equity (deficit)	$	231,143	$	145,462

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

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Overstock.com, Inc.

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three months ended September 30, 2007 (Restated)	Three months ended September 30, 2008	Nine months ended September 30, 2007 (Restated)	Nine months ended September 30, 2008
Revenue				
Direct revenue	$ 39,270	$ 34,176	$ 129,918	$ 125,771
Fulfillment partner revenue	120,789	152,679	341,468	452,734
Total revenue	160,059	186,855	471,386	578,505
Cost of goods sold				
Direct(1)	33,268	30,633	111,193	110,307
Fulfillment partner	99,425	124,103	282,025	368,899
Total cost of goods sold	132,693	154,736	393,218	479,206
Gross profit	27,366	32,119	78,168	99,299
Operating expenses:				
Sales and marketing(1)	8,835	11,934	28,081	41,197
Technology(1)	14,576	14,119	44,786	43,946
General and administrative(1)	9,724	10,321	30,842	30,751
Restructuring			12,283	
Total operating expenses	33,135	36,374	115,992	115,894
Operating loss	(5,769)	(4,255)	(37,824)	(16,595)
Interest income	1,291	664	3,359	2,708
Interest expense	(1,029)	(847)	(3,085)	(2,636)
Other income, net	(92)	2,849	(92)	2,851
Loss from continuing operations	(5,599)	(1,589)	(37,642)	(13,672)
Loss from discontinued operations			(3,924)	
Net loss	(5,599)	$ (1,589)	(41,566)	$ (13,672)
Net loss per common share basic and diluted:				
Loss from continuing operations	$ (0.24)	$ (0.07)	$ (1.59)	$ (0.60)
Loss from discontinued operations	$	$	$ (0.17)	$
Net loss per common share basic and diluted	$ (0.24)	$ (0.07)	$ (1.76)	$ (0.60)
Weighted average common shares outstanding basic and diluted	23,726	22,768	23,671	22,954

(1) Includes stock-based compensation from stock based awards as follows (Note 12):				
Cost of goods sold direct	$ 117	$ 44	$ 338	$ 143

Sales and marketing	$	85	$	76	$	248	$	246
Technology	$	195	$	193	$	560	$	627
General and administrative	$	1,269	$	543	$	2,870	$	2,707

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

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Overstock.com, Inc.

Consolidated Statements of Stockholders Equity (Deficit)

and Comprehensive Loss (unaudited)

(in thousands)

	Common stock		Additional Paid-in	Accumulated	Treasury stock		Accumulated Other Comprehensive	
	Shares	Amount	Capital	Deficit	Shares	Amount	Loss	Total
Balance at December 31, 2007 (Restated)	25,423	$ 2	$ 333,909	$ (252,327)	(1,605)	$ (63,278)	$ (94)	$ 18,212
Exercise of stock options	115		1,471					1,471
Stock-based compensation to employees and directors			3,242					3,242
Stock-based compensation to consultants in exchange for services			181					181
Stock-based compensation related to performance share plan			300					300
Treasury stock issued for 401(k) matching contribution			(41)		2	60		19
Purchase of treasury stock					(1,190)	(13,452)		(13,452)
Comprehensive loss:								
Net loss				(13,672)				(13,672)
Net unrealized loss on marketable securities							(27)	(27)
Cumulative translation adjustment							45	45
Total comprehensive loss								(13,654)
Balance at September 30, 2008	25,538	$ 2	$ 339,062	$ (265,999)	(2,793)	$ (76,670)	$ (76)	$ (3,681)

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

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three months ended September 30,		Nine months ended September 30,		Twelve months ended September 30,	
	2007 (Restated)	2008	2007 (Restated)	2008	2007 (Restated)	2008
Cash flows from operating activities of continuing operations:						
Net loss	$ (5,599)	$ (1,589)	$ (41,566)	$ (13,672)	$ (90,782)	$ (20,142)
Adjustments to reconcile net loss to cash provided by (used in) operating activities of continuing operations:						
Loss from discontinued operations			3,924		8,191	
Depreciation and amortization	7,080	5,580	22,825	17,964	34,350	24,634
Loss on disposition of property and equipment			1		1	
Stock-based compensation to employees and directors	1,176	990	3,386	3,242	4,418	4,378
Stock-based compensation to consultants for services	140	(134)	280	181	272	90
Stock-based compensation for performance share plan	350		350	300	350	(600)
Issuance of common stock from treasury for 401(k) matching contribution	213		928	19	1,036	(415)
Amortization of debt discount and deferred financing fees	86	85	258	257	258	343
Asset impairment and depreciation (other non-cash restructuring)			2,169		2,960	
Restructuring charges			10,114		14,997	
Notes receivable accretion	(136)	(136)	(136)	(408)	(136)	(544)
Gain from early extinguishment of debt		(2,849)		(2,849)		(2,849)
Changes in operating assets and liabilities, net of effect of discontinued operations:						
Accounts receivable, net	(942)	(104)	7,755	1,127	1,537	(1,806)
Inventories, net	(6,792)	(3,445)	152	8,162	40,877	6,237
Prepaid inventory	(2,879)	(1,904)	(2,762)	(980)	(979)	451
Prepaid expenses	(1,522)	(454)	(2,784)	(3,363)	(1,065)	(678)
Other long-term assets, net	100		366		967	105
Accounts payable	4,222	3,442	(26,199)	(35,699)	(10,253)	2,349
Accrued liabilities	(444)	1,109	(19,608)	(11,524)	(3,084)	2,176
Deferred revenue	2,605	(533)	(5,096)	(3,235)	2,392	1,606
Other long-term liabilities	(114)	(333)	(114)	(392)	(114)	(471)
Net cash provided by (used in) operating activities of continuing operations	(2,456)	(275)	(45,757)	(40,870)	6,193	14,864
Cash flows from investing activities of continuing operations:						
Purchases marketable securities	(7,783)	(10,186)	(29,164)	(35,548)	(29,164)	(81,601)

Sales and maturities of marketable securities	8,924	13,298	12,324	54,637	12,324	71,571
Expenditures for property and equipment	(316)	(8,809)	(2,232)	(15,258)	(5,998)	(15,669)
Proceeds from the sale of discontinued operations, net of cash transferred			9,892		9,892	
Collection of note receivable	502	250	5,196	1,506	5,196	1,506
Decrease in cash resulting from de-consolidation of variable interest entity					(102)	
Net cash (used in) provided by investing activities of continuing operations	1,327	(5,447)	(3,984)	5,337	(7,852)	(24,193)
Cash flows from financing activities of continuing operations:						
Payments on capital lease obligations	(5)		(5,256)	(3,796)	(5,335)	(3,801)
Drawdown on line of credit		1,326	1,169	7,722	9,347	8,976
Payments on line of credit		(1,326)	(1,169)	(7,722)	(9,347)	(8,976)
Issuance of common stock in offerings, net of issuance costs					39,406	
Purchase of treasury stock		(1,452)		(13,452)		(13,452)
Payments to retire senior convertible senior notes		(6,550)		(6,550)		(6,550)
Exercise of stock options	261	547	2,182	1,471	2,449	2,519
Net provided by (used in) financing activities of continuing operations	256	(7,455)	(3,074)	(22,327)	36,520	(21,284)
Effect of exchange rate changes on cash	(26)	23	(5)	(9)	18	(7)
Cash (used in) provided by operating activities from discontinued operations			(204)		1,265	
Cash used in investing activities of discontinued operations			(53)		(276)	
Net increase (decrease) in cash and cash equivalents	(899)	(13,154)	(53,077)	(57,869)	35,868	(30,620)
Change in cash and cash equivalents from discontinued operations			257		(990)	
Cash and cash equivalents, beginning of period	75,044	56,679	126,965	101,394	39,267	74,145
Cash and cash equivalents, end of period	$ 74,145	$ 43,525	$ 74,145	$ 43,525	$ 74,145	$ 43,525
Supplemental disclosure of cash flow information:						
Interest paid	$ 142	$ 847	$ 2,378	$ 3,010	$ 4,104	$ 4,514
Deemed dividend on redeemable common stock					33	
Lapse of rescission rights on redeemable common stock					2,431	
Promissory note received for deconsolidation of variable interest entity			6,000		6,000	
Promissory notes received as proceeds from sale of discontinued operations					6,702	
Prior year discretionary 401(k) contribution			408		408	

The accompanying notes are an integral part of these 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 regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited annual consolidated financial statements and related notes thereto included in the Annual Report on Form 10-K/A for the year ended December 31, 2007. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of results for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management s best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates. The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The consolidated financial statements include the accounts of the Company s OTravel subsidiary through April 25, 2007 (see Note 5 Sale of Discontinued Operations). All significant intercompany account balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires 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, valuation of investments, receivables valuation, revenue recognition, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets, internally-developed software, valuation of acquired intangibles, income taxes, stock-based compensation, and contingencies. Actual results could differ materially from those estimates.

Revenue recognition

The Company derives revenue related to merchandise sales primarily from two sources: direct revenue and fulfillment partner revenue. Fulfillment partner revenue also includes listing fees and commissions collected from products being listed and sold through the Auctions section of its Website, advertisement and lead generation revenue derived from its Cars listing site, and advertising revenue generated by its Real Estate site. The Company has organized its operations into two principal segments based on these primary sources of revenue (see Note 13 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 each 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 EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, 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, is subject to credit 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.

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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 accepted by its customers, are treated as a reduction to the sales price of the related transaction.

Direct revenue

Direct revenue consists of sales of merchandise to both individual consumers and businesses that are fulfilled directly from the Company s leased warehouses. Direct sales occur primarily through the Company s Website, but may also occur through other offline channels.

Fulfillment partner revenue

Fulfillment partner revenue consists of merchandise sold through the Company s Website and shipped by third parties directly to consumers and other businesses from warehouses maintained by the fulfillment partners, as well as revenue from the Auctions, Cars and Real Estate sections of its Website.

The auctions site 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, the Company is not considered the seller of the items sold on the auctions site and has 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. Auctions revenues were insignificant during the three and nine months ended September 30, 2007 and 2008, and are included in the fulfillment partner segment, as they are not large enough to separate out as a segment.

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 its cars listing business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

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. Advertising revenue from the real estate business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

The Company began selling products through its Website to customers outside the United States in late August 2008. The initial launch included Canada, the U.K., Germany and 31 other European countries. The Company does not have operations outside United States, and is utilizing 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 that is ordered is shipped from our warehouses or from a fulfillment partner.

Deferred revenue

Payment is generally required by credit card at the point of sale. Amounts owed or received prior to delivery of products or services provided are recorded as deferred revenue. Amounts received in advance for Club O membership fees are recorded as deferred revenue and recognized ratably over the membership period. In addition, the Company sells gift cards and records related deferred revenue at the time of the sale. Revenue from a gift card is recognized when a customer redeems it. If a gift card is not redeemed, the Company recognizes revenue when the likelihood of its redemption becomes remote.

Internal-Use Software and Website Development

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

During the three months ended September 30, 2007 and 2008, the Company capitalized $209,000 and $5.1 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $3.2 million and $2.9 million for those respective periods. For the nine months ended September 30, 2007 and 2008, the Company capitalized $1.7 million and $7.7 million of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $10.3 million and $9.1 million, respectively.

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Advertising expense

The Company recognizes advertising expenses in accordance with SOP 93-7, *Reporting on Advertising Costs*. As such, the Company expenses the costs of producing advertisements at the time production occurs or the first time the advertising takes place and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: (i) a commission for traffic driven to the Website that generates a sale, and (ii) based on the number of clicks on keywords or links to the Company s Website generated during a given period. Advertising expense included in sales and marketing expenses totaled $7.8 million and $10.6 million during the three months ended September 30, 2007 and 2008, respectively. For the nine months ended September 30, 2007 and 2008, advertising expenses totaled $25.5 million and $37.6 million, respectively.

Restructuring

Restructuring expenses are primarily comprised of lease termination costs and the costs incurred for returning leased facilities back to their original condition in anticipation of subleasing current office space. Statement of Financial Accounting Standard (SFAS) No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146), requires that when an entity ceases using a property that is leased under an operating lease before the end of its term contract, 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 4 Restructuring Expense).

Fair Value of Financial Instruments

In September 2006, the Financial Accounting Standards Board (FASB), issued SFAS No. 157, *Fair Value Measurements* (SFAS No.157), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position, (FSP), FAS No. 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS No. 157-2), which delayed the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted SFAS No. 157 for fiscal 2008, except as it applies to those non-financial assets and non-financial liabilities as described in FSP FAS No. 157-2, and it did not have a material impact on its consolidated financial position, results of operations or cash flows.

On a quarterly basis, the Company measures at fair value certain financial assets, including cash equivalents and available-for-sale securities. SFAS No. 157 specifies 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.

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 assets was determined using the following levels of inputs as of September 30, 2008 (in thousands):

	Fair Value Measurements as of September 30, 2008:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents Money market mutual funds	$ 19,776	$ 19,776	$	$
Available-for-sale securities	26,938	26,938		
Total assets	$ 46,714	$ 46,714	$	$

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Earnings (loss) per share

In accordance with SFAS No. 128, *Earnings per share*, basic earnings (loss) per share is computed by dividing net income (loss) attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, composed of incremental common shares issuable upon the exercise of stock options, restricted stock units, convertible senior notes and shares under the Performance Share Plan, are included in the calculation of diluted net earnings (loss) per share to the extent such shares are dilutive.

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

	Three months ended September 30,		Nine months ended September 30,	
	2007 (Restated)	2008	2007 (Restated)	2008
Loss from continuing operations	$ (5,599)	$ (1,589)	$ (37,642)	$ (13,672)
Loss from discontinued operations			(3,924)	
Net loss	$ (5,599)	$ (1,589)	$ (41,566)	$ (13,672)
Weighted average common shares outstanding basic	23,726	22,768	23,671	22,954
Effective of dilutive securities:				
Stock options				
Restricted stock units				
Convertible senior notes				
Shares under the Performance Share Plan				
Weighted average common shares outstanding diluted	23,726	22,768	23,671	22,954
Net loss per common share basic and diluted:				
Loss from continuing operations	$ (0.24)	$ (0.07)	$ (1.59)	$ (0.60)
Loss from discontinued operations	$	$	$ (0.17)	$
Net loss per common share basic and diluted	$ (0.24)	$ (0.07)	$ (1.76)	$ (0.60)

The stock options, restricted stock units, convertible senior notes outstanding and shares under the Performance Share Plan were not included in the computation of diluted earnings (loss) per share because to do so would have been antidilutive. The number of stock options outstanding at September 30, 2007 and 2008 was 1,176,000 and 986,000, respectively. In the first nine months of 2008, the Compensation Committee of the Board of Directors approved grants of approximately 12,000 stock options and 486,000 restricted stock units to officers and employees of the Company. As of September 30, 2008, there were 455,000 restricted stock units outstanding (see Note 12 Stock Based Awards). As of September 30, 2008, the Company had $67.5 million of convertible senior notes outstanding, which could potentially convert into 885,000 shares of common stock in the aggregate.

Recent accounting pronouncements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). Under SFAS No. 159, companies may elect to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 for fiscal 2008; however, it did not elect to apply the fair value option to any financial instruments or other items upon adoption of SFAS No. 159 during the nine months ended September 30, 2008. Therefore, the adoption of SFAS No. 159 did not impact the Company s consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations* (SFAS No. 141 (R)), and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS No. 160). SFAS No. 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquired entity at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company does not expect the adoption of SFAS No. 141 (R) or SFAS No. 160 to impact its financial position and results of operations or cash flows.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about a company s derivative and hedging activities, in particular: 1) how and why derivative instruments are utilized; 2) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and 3) how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. The Company has no derivative instruments. Therefore, the Company does not expect the adoption of SFAS No. 161 to impact its financial position and results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). The current GAAP hierarchy was established by the American Institute of Certified Public Accountants, and faced criticism because it was directed to auditors rather than entities. The issuance of this statement corrects this and makes some other hierarchy changes. This statement is effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The adoption of SFAS No. 162 did not result in a change to the Company s consolidated financial statements.

In May 2008, the FASB issued FASB Staff Position (FSP) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1), which clarifies the accounting for convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement. FSP APB 14-1 specifies that an issuer of such instruments should separately account for the liability and equity components of the instruments in a manner that reflect the issuer s non-convertible debt borrowing rate when interest costs are recognized in subsequent periods. The Company anticipates that the adoption of FSP APB 14-1 will not have a material impact on its consolidated financial statements.

3. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

Overstock.com, Inc. (the Company) is restating its consolidated financial statements for the quarter ended September 30, 2007 to correct errors related to the accounting for customer refunds and credits and the accounting for gift cards issued to customers.

The Company s decision to restate the aforementioned financial statements was made as a result of management s identification of errors related to the accounting for customer refunds and credits. On October 20, 2008, management, including the CEO (principal executive officer) and Senior Vice President, Finance (principal financial officer), concluded, and the Board of Directors agreed with management s conclusions that certain refunds and credits issued to customers were not completely and accurately recorded in the consolidated financial statements.

Management subsequently determined, and the Board of Directors adopted management s conclusion, that a portion of the error previously believed to be related to the accounting for customer refunds and credits was actually related to the accounting for gift cards issued to customers and that gift cards issued to customers were not completely and accurately recorded in the consolidated financial statements.

These errors impacted accounts receivable and deferred revenue in the consolidated balance sheet as well as revenue and returns expense (a component of revenue), in the consolidated statement of operations. As a result, revenue, net of returns expense, was misstated in the consolidated statement of operations for the three and nine months ended September 30, 2007 and accounts receivable and deferred revenue

were misstated in the consolidated balance sheet as of December 31, 2007. The amounts of these errors were determined to be material to the consolidated financial statements.

The effect of these error corrections on the Consolidated Results of Operations for the quarter ended September 30, 2007 is to increase the net loss by $634,000 (including decreasing $286,000 of direct revenue and $769,000 of fulfillment partner revenue and $75,000 of direct cost of goods sold and $346,000 of fulfillment partner cost of goods sold). The effect of these error corrections on the Consolidated Results of Operations for the nine months ended September 30, 2007 is to increase the net loss by $1.5 million (including decreasing $419,000 of direct revenue and $547,000 of fulfillment partner revenue and increasing $114,000 of direct cost of goods sold and $445,000 of fulfillment partner cost of goods sold).

In addition, from the Company s inception through the third quarter of 2007, the Company had recorded revenue based on product ship date. In the fourth quarter of 2007, the Company determined that it should not record revenue until product delivery date because risk of loss transfers to the customer upon delivery and acceptance. In the fourth quarter of 2007, the Company performed a detailed analysis of this error and determined that the impact of this error on any prior annual or interim period was not material and the impact of recording the cumulative effect of the error in the fourth quarter of 2007 was immaterial to the full year. Therefore, the Company recorded the cumulative effect of the error in the fourth quarter of 2007. However, as the Company is now restating its previously issued consolidated financial statements to correct accounting errors related to customer refunds and credits and gift cards issued to customers, it has reversed the cumulative effect of the correction of the error in the fourth quarter of 2007 and restated all prior periods to reflect revenue recognition based on the product s estimated delivery date in its consolidated financial statements for

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the years ended December 31, 2007, 2006, 2005, 2004 and 2003 (see Note 2 Accounting Policies). The Company also recorded other miscellaneous adjustments as part of this restatement that were previously identified but determined to be immaterial.

The effect of this error correction relating to product delivery date on the Consolidated Results of Operations for the quarter ended September 30, 2007 is to increase the net loss by $261,000 (including recognizing $110,000 direct revenue and deferring $926,000 of fulfillment partner revenue and recognizing a corresponding $183,000 of direct cost of goods sold and $738,000 of fulfillment partner cost of goods sold). The effect of this error correction on the Consolidated Results of Operations for the nine months ended September 30, 2007 is to increase the net loss by $186,000 (including recognizing $1.6 million of direct revenue and $1.9 million of fulfillment partner revenue and recognizing a corresponding $2.3 million of direct cost of goods sold and $1.4 million of fulfillment partner cost of goods sold). There was no effect of this error correction on the Consolidated Results of Operations for the three or nine months ended September 30, 2008 as this error was corrected by the Company during the fourth quarter of 2007.

The consolidated statements of operations for the three and nine months ended September 30, 2007, the consolidated balance sheet as of December 31, 2007 and statements of cash flows for the three, nine and twelve months ended September 30, 2007 have been restated as follows:

Consolidated Statements of Operations

(in thousands, except per share data)

	Quarter Ended September 30, 2007		
	As Previously Reported	**Adjustments**	**As Restated**
Revenue			
Direct	$ 39,446	(176)	$ 39,270
Fulfillment partner	122,484	(1,695)	120,789
Total revenue	161,930	(1,821)	160,059
Cost of goods sold			
Direct	33,160	108	33,268
Fulfillment partner	100,509	(1,084)	99,425
Total cost of goods sold	133,669	(976)	132,693
Gross profit	28,261	(895	27,366
Operating expenses:			
Sales and marketing	8,835		8,835
Technology	14,576		14,576
General and administrative	9,724		9,724
Restructuring			
Total operating expenses	33,135		33,135
Operating loss	(4,874)	(895)	(5,769)

Interest income	1,291		1,291
Interest expense	(1,029)		(1,029)
Other income, net	(92)		(92)
Loss from continuing operations	(4,704)	(895)	(5,599)
Loss from discontinued operations			
Net loss	(4,704)	(895)	(5,599)
Deemed dividend related to redeemable common shares			
Net loss attributable to common shares	$ (4,704)	$ (895)	$ (5,599)
Net loss per common share basic and diluted			
Loss from continuing operations	$ (0.20)	$ (0.04)	$ (0.24)
Loss from discontinued operations	$	$	$
Net loss per common share basic and diluted	$ (0.20)	$ (0.04)	$ (0.24)
Weighted average common shares outstanding basic and diluted	23,726		23,726

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Consolidated Statements of Operations

(in thousands, except per share data)

	Nine Months Ended September 30, 2007		
	As Previously Reported	Adjustments	As Restated
Revenue			
Direct	$ 128,725	174	$ 129,918
Fulfillment partner	240,102	1,889	341,468
Total revenue	468,827	2,063	471,386
Cost of goods sold			
Direct	108,801	608	111,193
Fulfillment partner	280,147	3,166	282,025
Total cost of goods sold	388,948	3,774	393,218
Gross profit	79,879	(1,711)	78,168
Operating expenses:			
Sales and marketing	28,081		28,081
Technology	44,786		44,786
General and administrative	30,842		30,842
Restructuring	12,283		12,283
Total operating expenses	115,992		115,992
Operating loss	(36,113)	(1,711)	(37,824)
Interest income	3,359		3,359
Interest expense	(3,085)		(3,085)
Other income, net	(92)		(92)
Loss from continuing operations	(35,931)	(1,711)	(37,642)
Loss from discontinued operations	(3,924)		(3,924)
Net loss	(39,855)	(1,711)	(41,566)
Deemed dividend related to redeemable common shares			
Net loss attributable to common shares	$ (39,855)	$ (1,711)	$ (41,566)
Net loss per common share basic and diluted			
Loss from continuing operations	$ (1.52)	$ (0.07)	$ (1.59)
Loss from discontinued operations	$ (0.17)	$	$ (0.17)
Net loss per common share basic and diluted	$ (1.69)	$ (0.07)	$ (1.76)
Weighted average common shares outstanding basic and diluted	23,671		23,671

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Consolidated Balance Sheets

(in thousands)

	As of December 31, 2007		
	As Previously Reported	Adjustments	As Restated
Assets			
Current assets:			
Cash and cash equivalents	$ 101,394	$	$ 101,394
Marketable securities	46,000		46,000
Cash, cash equivalents and marketable securities	147,394		147,394
Accounts receivable, net	12,304	(1,096)	11,208
Note receivable	1,506		1,506
Inventories, net	25,933	(290)	25,643
Prepaid inventory	3,572		3,572
Prepaid expenses	7,572		7,572
Total current assets	198,281	(1,386)	196,895
Property and equipment, net	27,197		27,197
Goodwill	2,784		2,784
Other long-term assets, net	86		86
Notes receivable	4,181		4,181
Total assets	232,529	$ (1,386)	$ 231,143
Liabilities, Redeemable Securities and Stockholders Equity			
Current liabilities:			
Accounts payable	$ 70,648	$ (290)	$ 70,358
Accrued liabilities	35,241	1,914	37,155
Deferred revenue	17,357	5,608	22,965
Capital lease obligations, current	3,796		3,796
Total current liabilities	127,042	7,232	134,274
Other long-term liabilities	3,034		3,034
Convertible senior notes	75,623		75,623
Total liabilities	205,699	7,232	212,931
Stockholders equity:			
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2007			
Common stock, $0.0001 par value, 100,000 shares authorized, 25,423 shares issued as of December 31, 2007	2		2
Additional paid-in capital	333,909		333,909
Accumulated deficit	(243,709)	(8,618)	(252,327)
Treasury stock, 1,605 shares at cost as of December 31, 2004	(63,278)		(63,278)
Accumulated other comprehensive loss	(94)		(94)
Total stockholders equity	26,830	(8,618)	18,212
Total liabilities, redeemable securities and stockholders equity	$ 232,529	$ (1,386)	$ 231,143

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three months ended September 30, 2007		
	As Reported	Adjustments	As Restated
Cash flows from operating activities of continuing operations:			
Net loss	$ (4,704)	$ (895)	$ (5,599)
Adjustments to reconcile net loss to cash provided by (used in) operating activities of continuing operations:			
Loss from discontinued operations			
Depreciation and amortization	7,080		7,080
Loss on disposition of property and equipment			
Stock-based compensation to employees and directors	1,176		1,176
Stock-based compensation to consultants for services	140		140
Stock-based compensation for performance share plan	350		350
Issuance of common stock from treasury for 401(k) matching contribution	213		213
Amortization of debt discount and deferred financing fees	86		86
Asset impairment and depreciation (other non cash restructuring)			
Restructuring charges			
Notes receivable accretion	(136)		(136)
Gain from early extinguishment of debt			
Changes in operating assets and liabilities, net of effect of discontinued operations:			
Accounts receivable, net	335	(1,277)	(942)
Inventories, net	(6,975)	183	(6,792)
Prepaid inventory	(2,879)		(2,879)
Prepaid expenses	(1,522)		(1,522)
Other long-term assets, net	100		100
Accounts payable	4,960	(738)	4,222
Accrued liabilities	(616)	172	(444)
Deferred revenue	50	2,555	2,605
Other long-term liabilities	(114)		(114)
Net cash provided by (used in) operating activities of continuing operations	(2,456)		(2,456)
Cash flows from investing activities of continuing operations:			
Purchases marketable securities	(7,783)		(7,783)
Sales and maturities of marketable securities	8,924		8,924
Expenditures for property and equipment	(316)		(316)
Proceeds from the sale of discontinued operations, net of cash transferred			
Collection of note receivable	502		502
Decrease in cash resulting from de-consolidation of variable interest entity			
	1,327		1,327

Net cash (used in) provided by investing activities of continuing operations				
Cash flows from financing activities of continuing operations:				
Payments on capital lease obligations		(5)		(5)
Drawdown on line of credit				
Payments on line of credit				
Issuance of common stock in offerings, net of issuance costs				
Purchase of treasury stock				
Payments to retire senior convertible senior notes				
Exercise of stock options		261		261
Net provided by (used in) financing activities of continuing operations		256		256
Effect of exchange rate changes on cash		(26)		(26)
Cash (used in) provided by operating activities from discontinued operations				
Cash used in investing activities of discontinued operations				
Net increase (decrease) in cash and cash equivalents		(899)		(899)
Change in cash and cash equivalents from discontinued operations				
Cash and cash equivalents, beginning of period		75,044		75,044
Cash and cash equivalents, end of period	$	74,145	$	74,145

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Nine months ended September 30, 2007		
	As Reported	Adjustments	As Restated
Cash flows from operating activities of continuing operations:			
Net loss	$ (39,855)	$ (1,711)	$ (41,566)
Adjustments to reconcile net loss to cash provided by (used in) operating activities of continuing operations:			
Loss from discontinued operations	3,924		3,924
Depreciation and amortization	22,825		22,825
Loss on disposition of property and equipment	1		1
Stock-based compensation to employees and directors	3,386		3,386
Stock-based compensation to consultants for services	280		280
Stock-based compensation for performance share plan	350		350
Issuance of common stock from treasury for 401(k) matching contribution	928		928
Amortization of debt discount and deferred financing fees	258		258
Asset impairment and depreciation (other non cash restructuring)	2,169		2,169
Restructuring charges	10,114		10,114
Notes receivable accretion	(136)		(136)
Gain from early extinguishment of debt			
Changes in operating assets and liabilities, net of effect of discontinued operations:			
Accounts receivable, net	3,731	4,024	7,755
Inventories, net	(2,126)	2,278	152
Prepaid inventory	(2,762)		(2,762)
Prepaid expenses	(2,784)		(2,784)
Other long-term assets, net	366		366
Accounts payable	(27,632)	1,433	(26,199)
Accrued liabilities	(19,367)	(241)	(19,608)
Deferred revenue	687	(5,783)	(5,096)
Other long-term liabilities	(114)		(114)
Net cash provided by (used in) operating activities of continuing operations	(45,757)		(45,757)
Cash flows from investing activities of continuing operations:			
Purchases marketable securities	(29,164)		(29,164)
Sales and maturities of marketable securities	12,324		12,324
Expenditures for property and equipment	(2,232)		(2,232)
Proceeds from the sale of discontinued operations, net of cash transferred	9,892		9,892
Collection of note receivable	5,196		5,196
Decrease in cash resulting from de-consolidation of variable interest entity			
	(3,984)		(3,984)

Net cash (used in) provided by investing activities of continuing operations				
Cash flows from financing activities of continuing operations:				
Payments on capital lease obligations		(5,256)		(5,256)
Drawdown on line of credit		1,169		1,169
Payments on line of credit		(1,169)		(1,169)
Issuance of common stock in offerings, net of issuance costs				
Purchase of treasury stock				
Payments to retire senior convertible senior notes				
Exercise of stock options		2,182		2,182
Net provided by (used in) financing activities of continuing operations		(3,074)		(3,074)
Effect of exchange rate changes on cash		(5)		(5)
Cash (used in) provided by operating activities from discontinued operations		(204)		(204)
Cash used in investing activities of discontinued operations		(53)		(53)
Net increase (decrease) in cash and cash equivalents		(53,077)		(53,077)
Change in cash and cash equivalents from discontinued operations		257		257
Cash and cash equivalents, beginning of period		126,965		126,965
Cash and cash equivalents, end of period	$	75,145	$	75,044

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Twelve months ended September 30, 2007		
	As Reported	**Adjustments**	**As Restated**
Cash flows from operating activities of continuing operations:			
Net loss	$ (85,469)	$ (5,313)	$ (90,782)
Adjustments to reconcile net loss to cash provided by (used in) operating activities of continuing operations:			
Loss from discontinued operations	8,191		8,191
Depreciation and amortization	34,350		34,350
Loss on disposition of property and equipment	1		1
Stock-based compensation to employees and directors	4,418		4,418
Stock-based compensation to consultants for services	272		272
Stock-based compensation for performance share plan	350		350
Issuance of common stock from treasury for 401(k) matching contribution	1,036		1,036
Amortization of debt discount and deferred financing fees	258		258
Asset impairment and depreciation (other non cash restructuring)	2,960		2,960
Restructuring charges	14,997		14,997
Notes receivable accretion	(136)		(136)
Gain from early extinguishment of debt			
Changes in operating assets and liabilities, net of effect of discontinued operations:			
Accounts receivable, net	(1,201)	2,738	1,537
Inventories, net	40,396	481	40,877
Prepaid inventory	(979)		(979)
Prepaid expenses	(1,065)		(1,065)
Other long-term assets, net	967		967
Accounts payable	(9,353)	(900)	(10,253)
Accrued liabilities	(4,575)	1,491	(3,084)
Deferred revenue	889	1,503	2,392
Other long-term liabilities	(114)		(114)
Net cash provided by (used in) operating activities of continuing operations	6,193		6,193
Cash flows from investing activities of continuing operations:			
Purchases marketable securities	(29,164)		(29,164)
Sales and maturities of marketable securities	12,324		12,324
Expenditures for property and equipment	(5,998)		(5,998)
Proceeds from the sale of discontinued operations, net of cash transferred	9,892		9,892
Collection of note receivable	5,196		5,196
Decrease in cash resulting from de-consolidation of variable interest entity	(102)		(102)
	(7,852)		(7,852)

Net cash (used in) provided by investing activities of continuing operations				
Cash flows from financing activities of continuing operations:				
Payments on capital lease obligations		(5,335)		(5,335)
Drawdown on line of credit		9,347		9,347
Payments on line of credit		(9,347)		(9,347)
Issuance of common stock in offerings, net of issuance costs		39,406		39,406
Purchase of treasury stock				
Payments to retire senior convertible senior notes				
Exercise of stock options		2,449		2,449
Net provided by (used in) financing activities of continuing operations		36,520		36,520
Effect of exchange rate changes on cash		18		18
Cash (used in) provided by operating activities from discontinued operations		1,265		1,265
Cash used in investing activities of discontinued operations		(276)		(276)
Net increase (decrease) in cash and cash equivalents		35,868		35,868
Change in cash and cash equivalents from discontinued operations		(990)		(990)
Cash and cash equivalents, beginning of period		39,267		39,267
Cash and cash equivalents, end of period	$	74,145	$	74,145

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4. RESTRUCTURING EXPENSE

During the fourth quarter of 2006, the Company began a facilities consolidation and restructuring program designed to reduce its overall expense structure in an effort to improve future operating performance, and incurred $5.7 million of restructuring charges related to the early termination of a data center lease.

During fiscal year 2007, the Company recorded $12.3 million of restructuring charges, of which $9.9 million related to the termination of a logistics services agreement, termination and settlement of a lease related to vacated warehouse facilities in Indiana, and abandonment and marketing for sub-lease office and data center space in the Company s current corporate office facilities. The Company also recorded an additional $2.2 million of restructuring charges related to accelerated depreciation of leasehold improvements located in the abandoned office and co-location data center space and $200,000 of other miscellaneous restructuring charges.

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

	Balance 12/31/2007	Charges to Expense	Cash payment	Balance 09/30/2008
Lease and contract termination costs	$ 4,035	$	$ (737)	$ 3,298
Total	$ 4,035	$	$ (737)	$ 3,298

Of the $3.3 million of restructuring liabilities, $2.6 million is classified in the balance sheet as Other long-term liabilities , with the remainder in accrued liabilities.

Under the restructuring program, the Company recorded $18.0 million in restructuring charges through the end of the second quarter of 2007, including $5.7 million in fiscal year 2006 and $12.3 million in fiscal year 2007. There were no restructuring charges during the nine months ended September 30, 2008. The costs incurred to date within each restructuring category approximate the costs that the Company had anticipated at the beginning of the program. The Company intends to move its corporate office facilities into new warehouse space leased on April 8, 2008 (see Note 9 Commitments and Contingencies). The Company believes that, except for the additional lease and contract termination costs related to relocating its current office facilities to the new warehouse location, the restructuring program is substantially complete.

5. SALE OF DISCONTINUED OPERATIONS

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

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

During the fourth quarter of 2006, in conjunction with the facilities consolidation and restructuring program described in Note 4, management decided to sell OTravel. The Company evaluated its plan to sell OTravel in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets* (SFAS No. 144), which requires that long-lived assets be classified as held for sale only when certain criteria are met. The Company classified the OTravel assets and liabilities as held for sale as it met these criteria as of December 31, 2006, which included: management s commitment to a plan to sell the assets; availability of the assets for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets has been initiated; sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; assets are being marketed at reasonable prices in relation to their fair value; and the unlikelihood that significant changes will be made to the plan. The travel business was not part of the Company s core business operations and was no longer part of its strategic focus. The results of operations for the subsidiary were included in the fulfillment partner segment prior to being classified as discontinued operations.

The Company also determined that the OTravel subsidiary met the definition of a component of an entity and accounted for it as a discontinued operation under SFAS No. 144. The results of operations for this subsidiary have been classified as discontinued operations in all periods presented. In conjunction with the discontinuance of OTravel, the Company performed an evaluation of the goodwill associated with the reporting unit pursuant to SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142) and SFAS No. 144 and determined that goodwill of approximately $4.5 million was impaired as of December 31, 2006, based on a non-binding letter of intent from a third party to purchase the business. During the quarter ended March 31, 2007, the Company received a revised offer from this third party to purchase its OTravel business and, in April 2007, the Company completed the sale of OTravel

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under these revised terms. Accordingly, the Company evaluated its goodwill as of March 31, 2007 and, based on the estimated fair value of the discounted cash flows of the net proceeds from the sale, determined that an additional $3.8 million of goodwill was impaired.

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

The following table is a summary of the Company s discontinued operations for the quarter-to-date period ended April 25, 2007 and the year-to-date period ended April 25, 2007 (in thousands):

	Quarter-to-date period ended April 25, 2007	Year-to-date period ended April 25, 2007
Sales	$ 145	$ 2,226
Cost of sales	(78)	(650)
Gross profit	67	1,576
Sales and marketing	(105)	(447)
Technology	(16)	(60)
General and administrative	(246)	(1,152)
Goodwill impairment		(3,841)
Loss from discontinued operations	$ (300)	$ (3,924)

6. MARKETABLE SECURITIES

The Company s marketable securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of stockholders equity, net of any tax effect. Realized gains or losses on the sale of marketable securities are determined using the specific-identification method.

The Company evaluates its investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and the Company s ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery of market value. The Company records an impairment charge to the extent that the carrying value of its available-for-sale securities exceeds the estimated fair market value of the securities and the decline in value is determined to be other-than-temporary. The Company did not record any impairment charges related to other-than-temporary decline in value of its marketable securities during the three or nine months ended September 30, 2007 or 2008.

As of September 30, 2008, the Company s marketable securities consisted of U.S. agency securities, commercial paper, and AAA-rated asset-backed securities collateralized by automobile loans/leases or credit card receivables. All marketable securities are classified as available-for-sale securities. The following table summarizes the Company s marketable security investments as of September 30, 2008 (in

thousands):

	Cost	Net Unrealized Gains (Losses)	Estimated Fair Market Value
Marketable securities:			
U.S. Agency Securities	$ 15,956	$ (18)	$ 15,938
Commercial Paper	9,967	(11)	9,956
Asset-Backed Securities	1,042	2	1,044
Total available-for-sale investments	$ 26,965	$ (27)	$ 26,938

There were no realized gains and losses on sales of marketable securities during the three and nine months ended September 30, 2007 and 2008.

7. OTHER COMPREHENSIVE LOSS

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

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	Three months ended September 30, 2007	Three months ended September 30, 2008	Nine months ended September 30, 2007	Nine months ended September 30, 2008
Net loss	$ (5,599)	$ (1,589)	$ (41,566)	$ (13,672)
Net unrealized gain (loss) on marketable securities	1	(24)	2	(27)
Foreign currency translation adjustment	(26)	77	(5)	45
Comprehensive loss	$ (5,624)	$ (1,536)	$ (41,569)	$ (13,654)

8. BORROWINGS

Wells Fargo Operational Credit Agreement

The Company has a credit agreement (as amended to date, the Credit Agreement) with Wells Fargo Bank, National Association (Wells Fargo). The Credit Agreement provides a revolving line of credit to the Company of up to $30.0 million which the Company uses primarily to obtain letters of credit to support operations, namely, inventory purchases. Interest on borrowings is payable monthly and accrued at either (i) 1.0% above LIBOR in effect on the first day of an applicable fixed rate term, or (ii) at a fluctuating rate per annum determined by the bank to be one half a percent (0.50%) above daily LIBOR in effect on each business day a change in daily LIBOR is announced by the bank. The Credit Agreement expires on January 1, 2010, and requires the Company to comply with certain covenants, including restrictions on mergers, business combinations and transfers of assets.

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

At September 30, 2008, no amounts were outstanding under the Credit Agreement, and letters of credit totaling $1.9 million were issued on behalf of the Company.

Wells Fargo Retail Finance Agreement

The Company is a party to a Loan and Security Agreement (the WFRF Agreement) with Wells Fargo Retail Finance, LLC and related security agreements and other agreements described in the WFRF Agreement.

The WFRF Agreement provides for advances to the Company and for the issuance of letters of credit for its account of up to an aggregate maximum of $40.0 million. The amount actually available to the Company may be less and may vary from time to time, depending on, among other factors, the amount of its eligible inventory and receivables. The Company s obligations under the WFRF Agreement and all related agreements are collateralized by all or substantially all of the Company s and its subsidiaries assets. The Company s obligations under the WFRF Agreement are cross-collateralized with its assets pledged under its $30.0 million credit facility with Wells Fargo Bank, N.A. The conditions to the Company s use of the facility include a 45-day advance notice requirement. The WFRF Agreement contains standard default provisions and

expires on December 12, 2008. The Company is currently negotiating to extend the term of the agreement, although there can be no assurance that it will be able to do so.

Advances under the WFRF Agreement bear interest at either (i) the rate announced, from time to time, within Wells Fargo Bank, N.A. at its principal office in San Francisco as its prime rate or (ii) a rate based on LIBOR plus a varying percentage between 1.25% and 1.75%; however, the annual interest rate on advances under the WFRF Agreement will be at least 3.50%. The WFRF Agreement includes affirmative covenants as well as negative covenants that prohibit a variety of actions without the lender s approval, including covenants that limit the Company s ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another person, (d) sell assets, (e) change its name or the name of any of its subsidiaries, (f) make certain changes to its business, (g) optionally prepay, acquire or refinance indebtedness, (h) consign inventory, (i) pay dividends on, or purchase, acquire or redeem shares of, its capital stock, (j) change its method of accounting, (k) make investments, (l) enter into transactions with affiliates, or (m) store any of its inventory or equipment with third parties. At September 30, 2008, no amounts were outstanding and, subject to the advance notice requirement, availability under the WFRF Agreement was $12.2 million.

Wells Fargo Commercial Purchasing Card Agreement

The Company has a commercial purchasing card agreement (the Purchasing Card) with Wells Fargo Bank, National Association (Wells Fargo). The Company uses the Purchasing Card primarily for business purpose purchasing and must pay it in full each month. Outstanding amounts under the Purchasing Card are collateralized by cash balances held at Wells Fargo Bank, N.A, and therefore the facility does not provide additional liquidity to the Company. At September 30, 2008, $809,000 was outstanding and

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$4.2 million was available under the Purchasing Card.

Capital leases

Software and equipment relating to expired capital leases totaled $19.8 million at September 30, 2007 and 2008, with accumulated depreciation of $14.7 million and $19.3 million at those respective dates. Depreciation of assets recorded under expired capital leases was $1.4 million and $836,000 during the three months ended September 30, 2007 and 2008, respectively. For the nine months ended September 30, 2007 and 2008, depreciation of assets recorded under capital leases was $4.2 million and $3.2 million, respectively. As of September 30, 2008, the Company had no remaining capital leases.

3.75% Convertible senior notes

In November 2004, the Company completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes). Proceeds to the Company were $116.2 million, net of $3.8 million of initial purchaser s discount and debt issuance costs. The discount and debt issuance costs are being amortized using the straight-line method which approximates the interest method. The Company recorded amortization of discount and debt issuance costs related to this offering totaling $86,000 and $85,000 during the three months ended September 30, 2007 and 2008, respectively. For the nine months ended September 30, 2007 and 2008, amortization of discount and debt issuance costs totaled $258,000 and $257,000, respectively. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

The Senior Notes are convertible at any time prior to maturity into the Company s common stock at the option of the note holders at a conversion price of $76.23 per share or, approximately 885,000 shares in aggregate (subject to adjustment in certain events, including stock splits, dividends and other distributions and certain repurchases of the Company s stock, as well as certain fundamental changes in the ownership of the Company). Beginning December 1, 2009, the Company has the right to redeem the Senior Notes, in whole or in part, for cash at 100% of the principal amount plus accrued and unpaid interest. Upon the occurrence of a fundamental change (including the acquisition of a majority interest in the Company, certain changes in the Company s board of directors or the termination of trading of the Company s stock) meeting certain conditions, holders of the Senior Notes may require the Company to repurchase for cash all or part of their notes at 100% of the principal amount plus accrued and unpaid interest.

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

Under the repurchase program discussed at Note 11 Stock and Debt Repurchase Program , the Company retired $9.5 million of the Senior Notes during the quarter ended September 30, 2008 for $6.6 million in cash, resulting in a gain of $2.8 million on early extinguishment of debt, net of $142,000 of associated unamortized discount. As of September 30, 2008, $67.5 million of the Senior Notes remained outstanding.

9. COMMITMENTS AND CONTINGENCIES

Commitments

Corporate office space

In July 2005, the Company leased approximately 154,000 rentable square feet in the Old Mill Corporate Center III in Salt Lake City, Utah for a term of ten years. The total lease obligation over the remaining term of this lease is $30.4 million, of which approximately $4.0 million is payable in the next twelve months. $8.0 million of the total lease obligation is offset by estimated sublease payments, of which $1.0 million is anticipated to be received in the next twelve months.

In the fourth quarter of 2006, the Company commenced implementation of a facilities consolidation and restructuring program. Under the program, the Company recorded $638,000 of accelerated amortization of leasehold improvements related to its subleased office facilities, and $450,000 of costs incurred to return its office facilities to their original condition as required by the lease agreement.

During fiscal year 2007, the Company recorded an additional $6.2 million of restructuring costs related to its marketing for sub-lease office and data center space in its current corporate office facilities. The Company also recorded an additional $2.2 million of restructuring charges related to accelerated depreciation of leasehold improvements located in the abandoned office and co-location data center space and $200,000 of other miscellaneous restructuring charges (see Note 4   Restructuring Expense   ).

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Logistics and warehouse space

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

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

In the first quarter of 2007, the Company terminated the Logistics Agreement and gave notice of intent to sublease the Indiana warehouse facilities under the License Agreement. During the second quarter of 2007, the Company reached an agreement to terminate the Indiana warehouse facilities lease effective August 15, 2007. As a result of the termination of the License agreement and warehouse lease, the Company incurred $3.7 million of related restructuring charges in 2007 (see Note 4 Restructuring Expense).

The Company currently leases 795,000 square feet for its warehouse facilities in Utah under operating leases which expire in August 2012 and August 2015.

On April, 8, 2008, the Company entered into a lease agreement with Natomas Meadows, LLC (Natomas Lease). The Natomas Lease is for a 686,865 square foot warehouse facility, now under construction in Salt Lake City, Utah (New Warehouse). The Natomas Lease provides that the Company will lease the New Warehouse in stages: on October 15, 2008, the Company leased the initial 232,900 square feet of the New Warehouse; on February 1, 2009, the Company will lease a total of 435,400 square feet; and, on September 1, 2009, the Company will lease the remainder, for a total of 686,865 square feet, less any space being used for the customer service facility and/or corporate office space. The Natomas Lease term is seven years, and specifies rent, exclusive of common area maintenance fees, at a variable rate over the course of the staged Lease term, ranging from $0.3300 per square foot for the first stage, to $0.3950 per square foot for the last year of the Natomas Lease term. Including the space now leased in the New Warehouse, the Company currently has warehouse operations in three facilities in Salt Lake City. Over the course of the staged Natomas Lease, the Company plans to consolidate from three facilities to two leased warehouse facilities in Salt Lake City. The warehouse being consolidated is under common ownership with Natomas Meadows, LLC. The common owner has agreed to cancel the Company s lease of that facility without any early termination penalty. The Natomas Lease anticipates that the Company may construct a corporate office facility within the New Warehouse. The Company constructed a 40,000 square foot customer service facility in the New Warehouse and commenced use of the facility on November 3, 2008. The Company intends to move its corporate office facility to the New Warehouse in the future.

Co-location data center

In July 2005, the Company entered into a Co-location Center Agreement (the Co-location Agreement) to build out and lease 11,289 square feet of space at Old Mill Corporate Center II for an IT co-location data center. The Co-location Agreement set forth the terms on which the Lessor would incur the costs to build out the IT co-location data center and the Company would commence to lease the space upon its completion for a

term of ten years. However, during the fourth quarter of 2006, the Company made the determination to consolidate its facilities and to not occupy the IT co-location data center, and the Co-location Agreement was terminated effective December 29, 2006, for which the Company incurred a $4.6 million restructuring charge (see Note 4 Restructuring Expense).

In December 2006, the Company entered into a Data Center Agreement (the OM I Agreement) to lease 3,999 square feet of space at Old Mill Corporate Center I for an IT data center to allow the Company to consolidate other IT data center facilities.

Computer equipment operating leases

The Company has two operating leases for certain computer equipment that expire in the first and fourth quarters of 2010. It is expected that such leases will be renewed by exercising purchase options or replaced by leases of other computer equipment.