OVERSTOCK.COM, INC
Form 10-Q
November 16, 2009
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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 September 30, 2009

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 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 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 22,836,264 shares of the Registrant s common stock, par value $0.0001, outstanding on November 9, 2009.

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EXPLANATORY NOTE

On November 13, 2009, Overstock.com, Inc. (the Company), dismissed Grant Thornton LLP (Grant Thornton) as the Company s independent registered public accounting firm. At the time of the dismissal, the Company and Grant Thornton had a disagreement on a matter of an accounting principle or practice. See Note 15 Subsequent Events. The Company has not yet engaged a successor accounting firm.

As a result of Grant Thornton LLP's dismissal, the accompanying 2009 unaudited interim financial statements and notes thereto for the quarterly periods ended September 30, 2009 have not been reviewed in accordance with Statement of Auditing Standards No. 100 (SAS 100), as required by Rule 10-01(d) of Regulation S-X promulgated under the Securities Act of 1934. The Company intends to file an amendment to this Form 10-Q to file unaudited interim financial statements for the quarterly periods ended September 30, 2009 reviewed in accordance with SAS 100 as required by Rule 10-01(d) as promptly as practicable after it has resolved outstanding matters addressed in a comment letter it has received from the Division of Corporation Finance of the Securities and Exchange Commission (SEC) and has engaged a successor independent registered public accounting firm.

Because the financial statements contained in this Form 10-Q do not meet the requirements of Rule 10-01 (d) of Regulation S-X, the Company may not be considered current in our filings under the Securities Exchange Act of 1934. Filing an amendment to this report, when the independent registered public accountants review is complete, would eliminate certain consequences of a deficient filing, but the Company may become ineligible to use Form S-3 to register securities until all required reports under the Securities Exchange Act of 1934 have been timely filed for the 12 months prior to the filing of the registration statement for those securities. The Company is evaluating the impact of filing a deficient Form 10-Q due to lack of a review by an independent registered public accounting firm on its covenants under its contractual commitments, its obligations under NASDAQ Stock Market listing standards, and the Securities Exchange Act.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets

(in thousands)

	December 31, 2008	September 30, 2009 (unaudited and unreviewed)
Assets		
Current assets:		
Cash and cash equivalents	$ 100,577	$ 79,111
Marketable securities	8,989	
Cash, cash equivalents and marketable securities	109,566	79,111
Accounts receivable, net	6,985	8,589
Notes receivable (Note 4)	1,250	
Inventories, net	17,723	17,532
Prepaid inventory, net	761	3,616
Prepaid expense	9,694	10,192
Total current assets	145,979	119,040
Fixed assets, net	23,144	20,536
Goodwill	2,784	2,784
Other long-term assets, net	538	2,015
Total assets	$ 172,445	$ 144,375
Liabilities and Stockholders Equity (Deficit)		
Current liabilities:		
Accounts payable	$ 62,120	$ 36,238
Accrued liabilities	25,154	29,034
Deferred revenue	19,026	19,192
Capital lease obligations, current		491
Total current liabilities	106,300	84,955
Other long-term liabilities	2,572	2,226
Capital lease obligations, non-current		892
Convertible senior notes, net	66,558	59,398
Total liabilities	175,430	147,471
Commitments and contingencies (Note 8)		
Redeemable common stock, $0.0001 par value, 63 shares outstanding as of September 30, 2009. No shares outstanding as of December 31, 2008 (Note 10)		705
Stockholders equity (deficit):		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2008 and September 30, 2009		
Common stock, $0.0001 par value, 100,000 shares authorized, 25,536 and 25,584 shares issued as of December 31, 2008 and September 30, 2009, and 22,743 and 22,704 shares	2	2

outstanding as of December 31, 2008 and September 30, 2009, respectively				
Additional paid-in capital		338,620		340,497
Accumulated deficit		(264,985)		(267,734)
Treasury stock, 2,793 and 2,817 shares at cost as of December 31, 2008 and September 30, 2009, respectively		(76,670)		(76,566)
Accumulated other comprehensive income		48		
Total stockholders deficit		(2,985)		(3,801)
Total liabilities and stockholders deficit	$	172,445	$	144,375

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

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Overstock.com, Inc.

Consolidated Statements of Operations (unaudited and unreviewed for 2009)

(in thousands, except per share data)

	Three months ended September 30, 2008	Three months ended September 30, 2009	Nine months ended September 30, 2008	Nine months ended September 30, 2009
Revenue, net				
Direct	$ 34,176	$ 32,369	$ 125,771	$ 96,216
Fulfillment partner	152,679	162,712	452,734	462,375
Total net revenue	186,855	195,081	578,505	558,591
Cost of goods sold				
Direct(1)	30,633	28,453	110,307	82,657
Fulfillment partner	124,103	128,959	368,899	364,666
Total cost of goods sold	154,736	157,412	479,206	447,323
Gross profit	32,119	37,669	99,299	111,268
Operating expenses:				
Sales and marketing(1)	11,934	12,187	41,197	36,849
Technology(1)	14,119	12,445	43,946	38,883
General and administrative(1)	10,321	13,191	30,751	38,849
Restructuring				(218)
Total operating expenses	36,374	37,823	115,894	114,363
Operating loss	(4,255)	(154)	(16,595)	(3,095)
Interest income	664	11	2,708	161
Interest expense	(847)	(941)	(2,636)	(2,550)
Other income, net	2,849	297	2,851	2,987
Net loss	$ (1,589)	$ (787)	$ (13,672)	$ (2,497)
Net loss per common share basic and diluted	$ (0.07)	$ (0.03)	$ (0.60)	$ (0.11)
Weighted average common shares outstanding basic and diluted	22,768	22,824	22,954	22,815

(1) Includes stock-based compensation as follows (Note 12):				
Cost of goods sold direct	$ 44	$ 30	$ 143	$ 93
Sales and marketing	76	120	246	336
Technology	193	178	627	527
General and administrative	543	507	2,707	1,613

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

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Overstock.com, Inc.

Consolidated Statement of Stockholders Equity (Deficit)

and Comprehensive Loss (unaudited and unreviewed for 2009)

(in thousands)

	Common stock		Additional Paid-in	Accumulated	Treasury stock		Accumulated Other Comprehensive	
	Shares	Amount	Capital	Deficit	Shares	Amount	Income (loss)	Total
Balances at December 31, 2008	25,536	$ 2	$ 338,620	$ (264,985)	(2,793)	$ (76,670)	$ 48	$ (2,985)
Stock-based compensation to employees and directors			2,559					2,559
Stock-based compensation to consultants in exchange for services			10					10
Restricted stock units issued upon vesting	110							
Exercise of stock options	1		3					3
Purchase of treasury stock					(36)	(333)		(333)
Treasury stock issued for corporate purposes				(252)	12	437		185
Redeemable common stock (Note 10)	(63)		(695)					(695)
Comprehensive loss :								
Net loss				(2,497)				(2,497)
Reclassification adjustment for realized loss included in net loss							(48)	(48)
Total comprehensive loss								(2,545)
Balances at September 30, 2009	25,584	$ 2	$ 340,497	$ (267,734)	(2,817)	$ (76,566)	$	$ (3,801)

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 and unreviewed for 2009)

(in thousands)

	Three months ended September 30, 2008	Three months ended September 30, 2009	Nine months ended September 30, 2008	Nine months ended September 30, 2009	Twelve months ended September 30, 2008	Twelve months ended September 30, 2009
Cash flows from operating activities:						
Net loss	$ (1,589)	$ (787)	$ (13,672)	$ (2,497)	$ (20,142)	$ (1,483)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:						
Depreciation and amortization, including internal-use software and website development	5,580	2,946	17,964	10,113	24,634	14,816
Realized loss on marketable securities				39		373
Loss on settlement of notes receivable (Note 4)						3,929
Loss on disposition of fixed assets				184		324
Stock-based compensation to employees and directors	990	835	3,242	2,559	4,378	3,339
Stock-based compensation to consultants for services	(134)		181	10	90	88
Stock-based compensation relating to performance share plan			300		(600)	(1,300)
Issuance of common stock from treasury for 401(k) matching contribution		185	19	185	(415)	185
Amortization of debt discount	85	125	257	270	343	347
Gain from early extinguishment of debt	(2,849)		(2,849)	(2,810)	(2,849)	(2,810)
Restructuring charges				(218)		(218)
Notes receivable accretion	(136)		(408)		(544)	(137)
Changes in operating assets and liabilities:						
Accounts receivable, net	(104)	(850)	1,127	(2,604)	(1,806)	1,038
Inventories, net	(3,445)	(5,509)	8,162	191	6,237	(51)
Prepaid inventory, net	(1,904)	(1,710)	(980)	(2,855)	451	302
Prepaid expense	(454)	1,668	(3,363)	(670)	(678)	571
Other long-term assets, net		377		(80)	105	(596)
Accounts payable	3,442	9,187	(35,699)	(25,882)	2,349	1,579
Accrued liabilities	1,109	3,833	(11,524)	3,762	2,176	3,005
Deferred revenue	(533)	1,922	(3,235)	166	1,606	(538)
Other long-term liabilities	(333)	(242)	(392)		(471)	(70)
Net cash provided by (used in) operating activities	(275)	11,980	(40,870)	(20,137)	14,864	22,693

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited and unreviewed for 2009) (Continued)

(in thousands)

Cash flows from investing activities:						
Purchases of marketable securities	(10,186)		(35,548)		(81,601)	
Maturities of marketable securities	13,298		54,637		71,571	9,905
Sale of marketable securities prior to maturity				8,902		16,642
Expenditures for fixed assets, including internal-use software and website development	(8,809)	(2,486)	(15,258)	(6,009)	(15,669)	(9,441)
Collection of note receivable	250		1,506	1,250	1,506	1,250
Net cash provided by (used in) investing activities	(5,447)	(2,486)	5,337	4,143	(24,193)	18,356
Cash flows from financing activities:						
Payments on capital lease obligations		(151)	(3,796)	(579)	(3,801)	(579)
Drawdowns on line of credit	1,326		7,722	1,612	8,976	6,853
Payments on line of credit	(1,326)		(7,722)	(1,612)	(8,976)	(6,853)
Payments to retire convertible senior notes	(6,550)		(6,550)	(4,563)	(6,550)	(4,563)
Purchase of treasury stock	(1,452)		(13,452)	(333)	(13,452)	(333)
Exercise of stock options	547	3	1,471	3	2,519	3
Net cash used in financing activities	(7,455)	(148)	(22,327)	(5,472)	(21,284)	(5,472)
Effect of exchange rate changes on cash	23		(9)		(7)	9
Net increase (decrease) in cash and cash equivalents	(13,154)	9,346	(57,869)	(21,466)	(30,620)	35,586
Cash and cash equivalents, beginning of period	56,679	69,765	101,394	100,577	74,145	43,525
Cash and cash equivalents, end of period	$ 43,525	$ 79,111	$ 43,525	$ 79,111	$ 43,525	$ 79,111
Supplemental disclosures of cash flow information:						
Interest paid	$ 847	$ 196	$ 3,010	$ 1,706	$ 4,514	$ 3,176
Equipment and software acquired under capital lease obligations	$	$ 276	$	$ 2,047	$	$ 2,047

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

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Overstock.com, Inc.

Notes to Unaudited and Unreviewed for 2009 Consolidated Financial Statements

1. BASIS OF PRESENTATION

The accompanying unaudited and unreviewed for 2009 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 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, 2008. The accompanying unaudited and unreviewed for 2009 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 month periods ended September 30, 2009 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 subsidiary. 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 and internally-developed software, valuation of acquired intangibles, income taxes, stock-based compensation, restructuring liabilities and contingencies. Actual results could differ materially from those estimates.

Fair value of financial instruments

The Company s financial instruments, including cash, cash equivalents, notes receivable, 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 Financial Accounting Standards Board (FASB) issued Codification of Accounting Standards (ASC) 820, *Fair Value Measurements,* (ASC Topic 820), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. ASC Topic 820 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. The Company adopted ASC Topic 820 on January 1, 2008, except as it applies to those non-financial assets and non-financial liabilities as described in ASC Topic 820-10-15, and it did not have a material impact on the Company s 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. ASC Topic 820 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

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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 estimated fair value of the Company s 3.75% Convertible Senior Notes due 2011 (Senior Notes) outstanding at December 31, 2008 and September 30, 2009 was $38.1 million on a face value of $67.5 million and $50.8 million on a face value of $60.0 million, respectively. The fair value of the Senior Notes was derived using a convertible pricing model with observable market inputs, which include stock price, dividend payments, borrowing costs, equity volatility, interest rates and interest spread.

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 all accounts receivable. The allowance for doubtful accounts receivable was $1.6 million at December 31, 2008 and $1.7 million at September 30, 2009.

Inventories

Inventories, consisting of merchandise purchased for resale, are accounted for using a standard costing system which approximates the first-in-first-out (FIFO) method of accounting, and are valued at the lower of cost or market. The Company establishes reserves for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. Once established, the original cost of the inventory less the related reserve represents the new cost basis of such products. Reversal of these reserves is recognized only when the related inventory has been sold or scrapped.

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 or amortized 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:

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

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	Three months ended September 30,		Nine months ended September 30,	
	2008	2009	2008	2009
Cost of goods sold - direct	$ 336	$ 314	$ 1,247	$ 960
Sale and marketing				
Technology	5,226	2,529	16,575	8,839
General and administrative	18	103	142	314
Total depreciation and amortization, including internal-use software and website development	$ 5,580	$ 2,946	$ 17,964	$ 10,113

Upon sale or retirement of assets, cost and related accumulated depreciation and amortization are removed from the balance sheet and the resulting gain or loss is reflected in the consolidated statements of operations.

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 ASC Topic 350-40, *Internal Use Software,* 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 month periods ended September 30, 2008 and 2009, the Company capitalized $5.1 million and $1.8 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally, in each period. Amortization of costs associated with internal-use software and website development was $2.9 million and $1.4 million for those respective periods. During the nine month periods ended September 30, 2008 and 2009, the Company capitalized $7.7 million and $4.3 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 $9.1 million and $4.5 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. 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 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 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

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customers, are treated as a reduction to the purchase price of the related transaction.

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.

Fulfillment partner revenue

Fulfillment partner revenue is derived from merchandise sales through the Company s Website which fulfillment partners ship 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. The revenue for the returned items the Company sells at auction is recorded on a gross basis. Revenue from the auctions business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own 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 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 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, as it is not significant enough to separate out as its own segment.

Total revenues from Auctions, Cars and Real Estate businesses were $495,000 and $1.5 million for the three and nine month periods ended September 30, 2009, respectively.

The Company began selling products through its website to customers outside the United States in August 2008. As of September 30, 2009, the Company was selling to customers in 39 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 $1.4 million and $2.8 million for the three and nine month periods ended September 30, 2009.

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.

Reserve for returns

Total net revenue is recorded net of estimated returns. The Company maintains a reserve 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 reserve 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 reserve for returns was $5.1 million at December 31, 2008, and $3.4 million at September 30, 2009.

Reserve for credit card chargebacks

Revenue is recorded net of credit card chargebacks. The Company maintains a reserve for credit card chargebacks based on current period revenues and historical chargeback experience. The reserve for chargebacks was $365,000 at December 31, 2008, and $157,000 at September 30, 2009.

Deferred revenue

Customer orders are recorded as deferred revenue prior to estimated delivery of products ordered or services rendered. 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.

Advertising expense

The Company recognizes advertising expenses in accordance with ASC Topic 720-35, *Advertising Costs*. As such, 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 Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled $10.6 million during each of the three month periods ended September 30, 2008 and 2009, respectively. For the nine month periods ended September 30, 2008 and 2009, advertising expenses totaled $37.6 million and $32.5 million, respectively. Prepaid advertising (included in Prepaid expense in the accompanying Consolidated Balance Sheets) was $877,000 at December 31, 2008, and $879,000 at September 30, 2009.

Stock-based compensation

As required by ASC Topic 718, *Compensation - Stock 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. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts will be recorded as an adjustment in the period estimates are revised. Management considers many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results may differ substantially from these estimates (see Note 12 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 established, 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. The accrual for a loss contingency might include, for example, estimates of potential damages, outside legal fees and other directly related costs expected to be incurred.

Restructuring

Restructuring expenses are primarily comprised of lease termination costs. ASC Topic 420, *Exit or Disposal Cost Obligations,* 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 3 Restructuring Expense).

Earnings (loss) per share

In accordance with ASC Topic 260, *Earnings Per Share*, basic earnings (loss) per share is computed by dividing net income (loss) attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, comprising incremental common shares issuable upon the exercise of stock options, restricted stock units and convertible senior notes are included in the calculation of diluted net income (loss) per common share to the extent such shares are dilutive.

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

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	Three months ended September 30, 2008	Three months ended September 30, 2009	Nine months ended September 30, 2008	Nine months ended September 30, 2009
Net loss	$ (1,589)	$ (787)	$ (13,672)	$ (2,497)
Weighted average common shares outstanding basic and diluted	22,768	22,824	22,954	22,815
Net loss per common share basic and diluted	$ (0.07)	$ (0.03)	$ (0.60)	$ (0.11)

The shares issuable related to stock options, restricted stock units, and 3.75% Convertible Senior Notes due 2011 (Senior Notes) outstanding were not included in the computation of diluted loss per common share for the three and nine month periods ended September 30, 2008 and 2009 because to do so would have been anti-dilutive. The number of shares issuable related to stock options outstanding was 986,000 shares and 724,000 shares as of September 30, 2008 and 2009, respectively. The number of shares issuable related to restricted stock units outstanding was 455,000 shares and 641,000 shares as of September 30, 2008 and 2009, respectively. As of September 30, 2009, the Company had $60.0 million of Senior Notes outstanding (see Note 7 Borrowings 3.75% Convertible Senior Notes), which could potentially convert into 787,000 shares of common stock in the aggregate.

Recent accounting pronouncements

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 168). SFAS No. 168, which is incorporated in ASC Topic 105, *Generally Accepted Accounting Principles*, identifies the ASC as the authoritative source of generally accepted accounting principles in the United States. Rules and interpretive releases of the SEC under federal securities laws are also sources of authoritative GAAP for SEC registrants. SFAS No. 168 was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted SFAS No. 168 in the third quarter of 2009 and included references to the ASC within its consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update 2009-13 (ASU 2009-13), which amends ASC Topic 605, *Revenue Recognition*, to require companies to allocate revenue in multiple-element arrangements based on an element s estimated selling price if vendor-specific or other third-party evidence of value is not available. ASU 2009-13 is effective beginning January 1, 2011. Earlier application is permitted. The Company is currently evaluating both the timing and the impact of the pending adoption of ASU 2009-13 on its consolidated financial statements.

The Company periodically reviews new accounting standards that are issued from time to time. Although some of these accounting standards may be applicable, management has not identified any other new standards that it believes merit further discussion or would have a significant impact on the consolidated financial statements.

Out of period adjustment

In the second quarter of 2009, the Company classified 63,000 shares or approximately $695,000 of the Company s common stock outside stockholders equity because the redemption features related to these unregistered shares were not within the Company s control (see Note 10). As this classification does not materially impact net income (loss) before income taxes and was not material to any of the prior years financial statements, both individually and in the aggregate, the Company recorded the classification of these unregistered shares in the second quarter of 2009 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, cash payments from sub-lessees, and adjustments associated with the facilities consolidation and restructuring program are as follows as of September 30, 2009 (in thousands):

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	Balance 12/31/2008	Charges to Expense	Cash payment	Adjustments	Balance 09/30/2009
Lease and contract termination costs liability	$ 3,184	$	$ (218)	$ (218)	$ 2,748

Under the restructuring program, the Company recorded $18.0 million in restructuring charges through the end of the second quarter of 2007. There were no additional restructuring charges during the nine month period ended September 30, 2009. The Company reversed approximately $218,000 of the lease and contract termination costs liability in the second quarter of 2009 due to the Company subleasing some of its abandoned office facilities earlier than it had originally estimated at the beginning of the program. The Company believes that, except for the additional lease and contract termination costs related to potentially abandoning and subleasing its current office facilities, the restructuring program is substantially complete. If the Company determines to move its corporate headquarters or consolidate from two warehouses to one, the Company expects it will incur future restructuring expenses.

4. ACQUISITION AND SUBSEQUENT 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 became a wholly-owned subsidiary of the Company and changed its name to OTravel.com, Inc (OTravel).

In the second quarter of 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 matured three years from the closing date and bore 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 matured five years from the closing date and bore interest of 8.0% per year, compounded annually, and was payable in full at maturity.

On January 21, 2009, the Company entered into a Note Purchase Agreement to settle the senior and junior promissory notes to Castles Travel, Inc. for approximately $1.3 million in cash and recognized a loss on the settlement of these notes and interest receivable of approximately $3.9 million as of December 31, 2008.

5. 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 and recognized in the statement of operations.

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 and nine month periods ended September 30, 2008 and 2009. There were no realized gains and losses on sales of marketable securities during the three and nine month periods ended September 30, 2008 and realized losses on the sale of marketable securities were $39,000 for the nine month period ended September 30, 2009. The Company held no marketable securities at September 30, 2009.

6. OTHER COMPREHENSIVE LOSS

The Company follows ASC Topic 220, *Comprehensive Income.* This Topic 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,		Nine months ended September 30,	
	2008	2009	2008	2009
Net loss	$ (1,589)	$ (787)	$ (13,672)	$ (2,497)
Net unrealized gain on marketable securities	(24)		(27)	
Reclassification adjustment for realized loss included in net loss				(48)
Foreign currency translation adjustment	77		45	
Comprehensive loss	$ (1,536)	$ (787)	$ (13,654)	$ (2,545)

7. BORROWINGS

Wells Fargo 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 inventory purchases. Interest on borrowings is payable monthly and accrues 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 or transfer 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, 2009, no amounts were outstanding under the Credit Agreement, and letters of credit totaling $2.3 million were issued on behalf of the Company supported by cash balances held at Wells Fargo, which is included in Cash and cash equivalents in the accompanying Consolidated Balance Sheets.

Wells Fargo Retail Finance Agreement

On August 3, 2009, Overstock.com, Inc. terminated the Amended and Restated Loan and Security Agreement dated January 6, 2009 (the Amended WFRF Agreement) with Wells Fargo Retail Finance, LLC (WFRF).

Wells Fargo Commercial Purchasing Card Agreement

The Company has a commercial purchasing card agreement (the Purchasing Card) with Wells Fargo. The Company uses the Purchasing Card for business purpose purchasing and must pay current balances in full each month. Outstanding amounts under the Purchasing Card are collateralized by cash balances held at Wells Fargo and therefore the facility does not provide additional liquidity to the Company. At September 30, 2009, $825,000 was outstanding and $425,000 was available under the Purchasing Card.

Capital leases

The Company leased certain software and computer equipment during the three and nine month periods ended September 30, 2009 under non-cancelable leases that expire on various dates through 2012.

Software and computer equipment relating to the capital leases totaled $1.7 million at September 30, 2009, with accumulated amortization of $180,000. Amortization expense of assets recorded under capital leases was $836,000 and $137,000 for the three month periods ended September 30, 2008 and September 30, 2009, respectively. For the nine month periods ended September 30, 2008 and 2009, amortization of assets recorded under capital leases was $3.2 million and $180,000, respectively. Future payments of capital lease obligations are as follows (in thousands):

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Payments due by period		
2009 (remainder)	$	99
2010		646
2011		794
2012		116
Total minimum lease payments		1,655
Less: amount representing interest		(272)
Present value of capital lease obligations		1,383
Less: current portion		491
Capital lease obligations, non-current	$	892

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 interest method. The Company recorded amortization of discount and debt issuance costs related to this offering totaling $85,000 and $68,000 during the three month periods ended September 30, 2008 and 2009, respectively. For the nine month periods ended September 30, 2008 and 2009, respectively, the Company recorded amortization of discount and debt issuance costs totaling $257,000, and $213,000. 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 787,000 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 on or after December 31, 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.

On February 17, 2009, the Board of Directors approved a debt repurchase program that authorizes the Company to use up to an additional $20.0 million in cash to repurchase a portion of its Senior Notes. For the nine month period ended September 30, 2009, the Company retired a total of $7.4 million of its Senior Notes for $4.6 million in cash and recorded a $2.8 million gain, net of amortization of debt discount of $92,000 (see Note 11 Stock and Debt Repurchase Program). As of September 30, 2009, a face amount of $60.0 million of the Senior Notes remain outstanding.

8. 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. As of September 30, 2009, the total lease obligation over the remaining term of this lease is $26.4 million, of which approximately $4.1 million is payable in the next twelve months. $7.8 million of the total lease obligation is offset by estimated sublease payments related to the Company s restructuring plan, of which $1.3 million is anticipated to be received in the next twelve months.

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Logistics and warehouse space

The Company leases 1,002,678 square feet for its warehouse operations in two facilities in Salt Lake City, Utah under operating leases which expire in August 2012 and February 2016.

On April 8, 2008, the Company entered into a lease agreement with Natomas Meadows, LLC (the Natomas Lease) for a 686,865 square foot warehouse facility located in Salt Lake City, Utah (the New Warehouse). 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 to $0.3950 per square foot for the last year of the lease term. 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.

Co-location data center

The Company leases approximately 4,000 square feet of space at Old Mill Corporate Center I for an IT data center. The lease expires on May 1, 2017.

The Company leases an additional 2,864 square feet for an offsite IT data center located in Salt Lake City. The lease expires on June 30, 2011.

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 exercise of purchase options or replaced by leases of other computer equipment.

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of September 30, 2009, are as follows (in thousands):

Payments due by period		
2009 (remainder)	$	2,320
2010		9,391
2011		9,322
2012		8,868

2013		8,325
Thereafter		15,036
	$	53,262

Rental expense for operating leases totaled $1.7 million and $2.2 million for the three month periods ended September 30, 2008 and 2009, respectively. For the nine month periods ended September 30, 2008 and 2009, rental expense totaled $7.5 million and $6.3 million, respectively.

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 s business and the sale of products on the Company s website. In connection with such litigation, the Company may be subject to significant damages or equitable remedies. Such litigation could be costly and time consuming and could divert its 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 August 11, 2005, along with shareholder plaintiffs, the Company filed a complaint against Gradient Analytics, Inc.; Rocker Partners, LP; Rocker Management, LLC; Rocker Offshore Management Company, Inc. and their respective principals in the Superior Court of California, County of Marin. On October 12, 2005, the Company filed an amended complaint against the same entities alleging libel, intentional interference with prospective economic advantage and violations of California s unfair business practices act. On October 10, 2008, the Company and Patrick Byrne reached a confidential settlement agreement with Gradient Analytics and its current and former principals and those defendants have been dismissed from the case. On October 22, 2008, the Company amended the complaint to name as additional defendants Cathy Longinotti, Mark Montgomery, Phillip Renna and Terrence Warzecha because of their former or existing status as general partners of Copper River Partners, L.P. On December 15, 2008 all the newly named defendants filed an Anti-SLAPP motion to strike the amended complaint; a demurrer to the second, fourth and fifth causes of action; and a motion to quash the summons for defendants Longinotti, Renna and Warzecha for lack of jurisdiction. On April 23, 2009, the court denied defendants Anti-SLAPP motion and demurrers, but granted the motion to quash the summons for

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newly named defendants Longinotti, Renna and Warzecha. On May 14, 2009, the shareholder plaintiffs dismissed their claims against the defendants. The parties are in the discovery phase of the case. Trial is set for February 9, 2010. The Company intends to continue to pursue this action vigorously against all of the Rocker entities and their principals.

On November 9, 2007, Copper River Partners, L.P. (formerly known as Rocker Partners, LP) filed a cross-complaint against the Company and certain of its current and former directors. The Copper River cross-complaint alleges cross-defendants have engaged in violations of California s state securities laws, violations of California s unfair business practices act, tortuous interference with contract and prospective business advantage, and deceit. In January 2008, each of the cross-defendants filed various motions in opposition of this cross-complaint. On April 23, 2008, the court dismissed Copper River s cross claims against former Company directors, John Byrne and Jason Lindsey, and current Company director Allison Abraham. In that same ruling, the court dismissed four of the six claims against former Company director John Fisher: securities fraud, unfair business practices, common law fraud and equitable indemnity. In a separate ruling on the same day relating to the Company and Patrick Byrne, the court dismissed the common law fraud claims and equitable indemnity claims and eliminated the possibility of money damages under Copper River s claims that Overstock and Byrne engaged in unfair business practices. In other portions of the court s rulings, the court declined to dismiss Copper River s securities fraud claims and its request for an injunction for unfair business practices against the Company and Patrick Byrne and the claims for tortuous interference with contract and prospective business advantage against the Company, Patrick Byrne and John Fisher. On June 20, 2008 Copper River dismissed its complaints against Mr. Fisher. The parties are in the discovery phase of the case. Trial is set for February 9, 2010. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. The Company intends to continue to defend the Copper River cross-complaint vigorously.

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 alleges that the defendants, who control over 80% of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as fails to deliver and that the defendants actions caused and continue to cause dramatic distortions 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 accuses the defendants of violations of California securities laws and common law, specifically, conversion, trespass to chattels, intentional interference with prospective economic advantage, and violations of California s Unfair Business Practices Act. 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 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 allegations of collective action 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. No trial date has been set. 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

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to the pricing of a list of product items identified in the subpoena. The Company has responded to the subpoena. 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. Plaintiffs and Defendants, including the Company, have stipulated to an extension in the time for answering the complaint, while the parties engage in a mediation of the dispute. The Company has not responded to the Complaint. The Company has notified Facebook, Inc. of its indemnification obligations under the contract by which the Company obtained and deployed Facebook Beacon. The parties have entered stipulation specifying the party defendants need not answer the complaint while the parties discuss resolution alternatives. The Plaintiff and Facebook proposed a stipulated resolution to the court for approval, which would resolve the case without requirement of financial contribution from the Company. A third party has intervened to block the approval. It is unknown whether the Court will approve the proposed stipulation. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. If the case is not settled, the Company intends to vigorously defend this action and pursue with Facebook its indemnification rights under the Facebook Beacon agreement.

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. The Company has since 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. The Company believes the determinations to be wrong and will vigorously contest the determinations.

On January 22, 2009, the Company, along with seven other defendants was sued in a patent infringement law suit by SBJ IP Holdings 1, LLC, (SBJ IP Holdings) in the United States District Court, Eastern District of Texas. The Company is alleged to have infringed a patent owned by the plaintiff involving certain processes by which online retail companies make product purchase recommendations to their customers. Two third-party vendors who sold recommendation software products to the Company affirmed the Company s indemnification rights against them. The Company and SPJIP Holdings settled the lawsuit in a confidential settlement by which the company obtained a license for the patent in suit. The case was dismissed on September 11, 2009.

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 is the nominative plaintiff. Ms. Hines 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 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 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 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 has filed a Notice of Appeal of the court s ruling. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. The suit is in 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

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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 under vendor agreements to indemnify the Company in this action. 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 us 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 under vendor agreements to indemnify the Company in this action. The Company has not yet been served with the complaint or summons and has not answered the complaint. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. If served, the Company intends to 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.

9. 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, events or contingencies. 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, indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware, and various other indemnities undertaken in connection with a variety of service contracts. The duration of these indemnities, commitments, and guarantees varies, and in certain cases, is indefinite. In addition, the majority of these indemnities, commitments, and guarantees do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. As such, the Company is unable to estimate with any reasonableness its potential exposure under these items. The Company has not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. The Company does, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable. The Company carries specific and general liability insurance policies that the Company believes would, in most circumstances, provide some, if not total recourse to any claims arising from these indemnifications.

10. REDEEMABLE COMMON STOCK

In June 2009, the Company discovered that it inadvertently issued 201,421 more shares of the Company s common stock in connection with its 401(k) plan than had been registered with the Securities and Exchange Commission for offer in connection with the 401(k) plan. These shares were contributed to or otherwise acquired by participants in the 401(k) plan between August 16, 2006, and June 17, 2009. As a result, certain participants in the 401(k) plan may have 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 September 30, 2009, approximately 63,000 shares or $705,000 of the Company s common stock plus 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 but has determined that it is unable to do so at the present time. Consequently, the Company and the Committee 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.

Based on the closing price of Overstock common stock of $14.67 at September 30, 2009, the Company anticipates that of the $695,000 of affected stock outstanding as of September 30, 2009, it would be uneconomical for participants to attempt to rescind their acquisitions of more than $136,569 of the stock.

11. STOCK AND DEBT REPURCHASE PROGRAM

On January 14, 2008, the Company s Board of Directors authorized a repurchase program that allowed the Company to purchase up to $20.0 million of its common stock and or its 3.75% Senior Convertible Notes due 2011 (Senior Notes) through December 31, 2009. Under this repurchase program, the Company repurchased approximately 1.2 million shares of its common stock

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in open market purchases for $13.4 million as of December 31, 2008. In addition, during the year ended 2008, the Company retired $9.5 million of the Senior Notes for $6.6 million in cash. As a result of the Senior Notes retirements, the Company recognized a gain of $2.8 million, net of the associated unamortized discount of $142,000 for the year ended December 31, 2008. The Company fully used this authorized $20.0 million repurchase program by December 31, 2008.

On February 17, 2009, the Board of Directors approved a debt repurchase program that authorizes the Company to use up to an additional $20.0 million in cash to repurchase a portion of its Senior Notes. For the nine month period ended September 30, 2009, the Company retired a total of $7.4 million of its Senior Notes for $4.6 million in cash and recorded a $2.8 million gain, net of amortization of debt discount of $92,000. During the three month period ended September 30, 2009, the Company did not retire any of its Senior Notes.

12. STOCK-BASED AWARDS

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

Stock-based compensation expense recognized under ASC Topic 718, *Compensation - Stock Compensation,* was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2008	**2009**	**2008**	**2009**
Stock options	$ 581	$ 379	$ 2,815	$ 1,265
Restricted stock units	275	456	608	1,304
Performance shares			300	
Total stock-based compensation expense	$ 856	$ 835	$ 3,723	$ 2,569

As of September 30, 2009, there was $6.8 million of net unrecognized compensation cost related to stock-based compensation arrangements.

Stock options

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. The weighted average grant date fair value of options granted and the weighted average assumptions used in the model for the three and nine month periods ended September 30, 2008 were as follows (there were no options granted during the three and nine month periods ended September 30, 2009):

	Nine months Ended September 30,	
	2008	2009
Dividend yield	None	N/A
Expected volatility	61.9%	N/A
Risk-free interest rate	2.70%	N/A
Expected life (in years)	6.3	N/A
Weighted average fair value of options granted	$ 10.67	$ N/A

The computation of the expected volatility assumption used in the BSM pricing model for new grants is based on implied volatility. When establishing the expected life assumption, the Company reviews annual historical employee exercise behavior with respect to option grants having similar vesting periods. 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.

Stock options outstanding totaled 974,000 and 724,000 options at December 31, 2008 and September 30, 2009, respectively. These totals include all stock option awards outstanding, without regard for estimated forfeitures, consisting of vested and unvested awards, and in-the-money and out-of-the-money stock options.

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Restricted stock units

During the nine month period ended September 30, 2009, the Compensation Committee of the Board of Directors approved grants of 366,700 restricted stock units to officers and employees of the Company of which 1,000 restricted stock units were granted during the three month period ended September 30, 2009. The cost of restricted stock units is determined using the fair value of the Company s common stock on the date of the grant, and compensation expense is recognized in accordance with the vesting schedule. The weighted average grant date fair value of restricted stock units granted during the three and nine month periods ended September 30, 2009 was $13.54 and $10.13 per stock unit, respectively.

The following table summarizes the Company s restricted stock unit activity for the nine month period ended September 30, 2009 (in thousands):

	Number of Units
Outstanding at December 31, 2008	449
Units granted	367
Units vested	(110)
Units cancelled	(65)
Outstanding at September 30, 2009	641

The restricted stock units 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 September 30, 2009, there were 641,000 restricted stock units that remained outstanding.

Performance share plan

In January 2006, the Board of Directors and Compensation Committee adopted the Overstock.com Performance Share Plan (the Plan) and approved grants to executive officers and certain employees of the Company. The Plan provided for a three-year period for the measurement of the Company s attainment of the performance goal described in the form of grant.

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

During the year ended December 31, 2008, the Company reversed the $1.3 million cumulative total of compensation expense accrued under the Plan as the Board determined no payments would be made under the Plan. The Plan expired December 31, 2008.

13. 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 nine month periods ended September 30, 2008 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 nine month periods ended September 30, 2008 and 2009 (in thousands):

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	Three months ended September 30,			Nine months ended September 30,		
	Direct	Fulfillment partner	Total	Direct	Fulfillment partner	Total
2008						
Revenue, net	$ 34,176	$ 152,679	$ 186,855	$ 125,771	$ 452,734	$ 578,505
Cost of goods sold	30,633	124,103	154,736	110,307	368,899	479,206
Gross profit	$ 3,543	$ 28,576	$ 32,119	$ 15,464	$ 83,835	$ 99,299
Operating expenses			(36,374)			(115,894)
Other income (expense), net			2,666			2,923
Net loss			$ (1,589)			$ (13,672)
2009						
Revenue, net	$ 32,369	$ 162,712	$ 195,081	$ 96,216	$ 462,375	