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

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K/A

**Amendment No.1**

**(Mark One)**

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

**For the fiscal year ended December 31, 2006**

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

**6350 South 3000 East**
**Salt Lake City, Utah 84121**

(Address of principal executive offices including zip code)

**(801) 947-3100**

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **Common Stock, $0.0001 par value** (title of class)

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A, or any amendment to this Form 10-K/A. o

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

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

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of the last business day of the registrant s most recently completed second quarter (June 30, 2006), was approximately $143.8 million based upon the last sales price reported by NASDAQ. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

As of March 9, 2007 there were 23,612,071 shares of the registrant s Common Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain information required by Part III of Form 10-K/A is incorporated by reference to the Registrant s proxy statement for the 2007 Annual Stockholders Meeting, which will be filed with the Securities and Exchange Commission.

**EXPLANATORY NOTE**

Overstock.com, Inc. (also referred to as the Company, We, or our ) is filing this Amendment No. 1 (the Amendment No. 1 ) to our Form 10-K for the fiscal year ended December 31, 2006 (the Form 10-K ), originally filed with the Securities and Exchange Commission on March 14, 2007, for the purpose of providing currently dated 302 and 906 certifications, as the dates on the 906 certifications were omitted from the original filing.

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

**OVERSTOCK.COM, INC.**

**ANNUAL REPORT ON FORM 10-K/A**

**INDEX**

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Form 10-K/A contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are therefore entitled to the protection of the safe harbor provisions of these laws. These forward-looking statements involve risks and uncertainties, and relate to future events or our future financial or operating performance. These statements include, but are not limited to, statements concerning:

the anticipated benefits and risks of our business relationships;

our ability to attract retail and business customers;

the anticipated benefits and risks associated with our business strategy;

our future operating results;

the anticipated size or trends of the market segments in which we compete and the anticipated competition in those markets;

potential government regulation;

our future capital requirements and our ability to satisfy our capital needs;

our expansion in international markets;

the potential for additional issuances of our securities;

our plans to devote substantial resources to our sales and marketing teams;

the possibility of future acquisitions of businesses, products or technologies;

the possibility of future sales of portions of our business and the anticipated associated benefits;

our belief that we can attract customers in a cost-efficient manner;

our strategy to develop strategic business relationships with additional wholesalers and distributors;

our strategy to reduce costs associated with our existing expense structure and the anticipated associated benefits;

our belief that current or future litigation will likely not have a material adverse effect on our business;

the anticipated anti-takeover effects of certain provisions of our charter documents;

the ability of our online marketing campaigns to be a cost-effective method of attracting customers;

the results of upgrades to our infrastructure and the likelihood that additional future upgrades can be implemented without disruption of our business;

our belief that manufacturers will recognize us as an efficient liquidation solution;

our belief that the increases we have made in the scope of our Books, Music and Video department offerings will be attractive to customers and will result in increased sales of higher margin products;

our belief that we can meet our published product shipping standards even during periods of relatively high sales activity;

our belief that we can maintain or improve upon customer service levels that we and our customers consider acceptable;

our belief that our information technology infrastructure can and will support our operations and will not suffer significant downtime;

our belief that we can maintain inventory levels at appropriate levels despite the seasonal nature of our business; and

our belief that we can successfully offer and sell a constantly changing mix of products and services.

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

**PART I**

**ITEM 1.** BUSINESS

*The following description of our business contains forward-looking statements relating to future events or our future financial or operating performance that involve risks and uncertainties, as set forth above under Special Note Regarding Forward-Looking Statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth in Section 1A under the heading Risk Factors and elsewhere in this Form 10-K/A.*

**Overview**

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

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

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

**Industry Overview**

Manufacturers and retailers traditionally hold inventory to buffer against uncertain demand within their normal, inline sales channels. Inline sales channels are manufacturers primary distribution channels, which are characterized by regularly placed orders by established retailers at or near wholesale prices. In recent years, several dynamics have shifted inventory risk from retailers to manufacturers, including:

- dominant retailers insist on just-in-time deliveries from manufacturers;
- dominant retailers cancel orders mid-production and return unsold merchandise;
- style, color or model changes quickly turn inventory into closeout merchandise;
- incorrect estimates of consumer demand lead to overproduction; and
- changes in a retailer s financial situation or strategy result in cancelled orders.

The disposal of excess, or overstock, inventory represents a substantial burden for many manufacturers, especially those who produce high-quality branded merchandise. Manufacturers seek to avoid liquidating through traditional retail channels where the manufacturer s discounted products may be sold alongside other full-price products. This can result in weaker pricing and decreased brand strength, and is known as channel conflict or sales channel pollution. As a result, many manufacturers turn to liquidation wholesalers and discount retailers. These liquidation channels provide manufacturers limited control of distribution and are, we believe, unreliable and expensive to manage when compared with their inline channels.

Despite the challenges encountered by manufacturers in the liquidation market, the proliferation of outlet malls, wholesale clubs, and discount chains is evidence of the strong level of consumer demand for discount and closeout merchandise. However, consumers face several difficulties in shopping for closeout and overstock merchandise. For example, many traditional merchandise liquidation outlets are located in remote locations and have limited shopping hours, which we believe makes shopping burdensome and infrequent for many consumers. In addition, the space available in a traditional merchandise liquidation outlet constrains the number of products that a traditional merchandise liquidation outlet can offer at any given time.

However, we believe that the market for online liquidation is still early in its development and is characterized by only a limited number of competitors, some of which utilize an auction model to price their goods. Furthermore, we believe that there are no other dominant companies in the online liquidation market, and many of the companies that do offer overstock or liquidation merchandise are focused on single product lines.

Lastly, small retailers are under competitive pressure from large national retailers. Small retailers generally do not have purchasing leverage with manufacturers; consequently, they are more likely to pay full wholesale prices and are more likely to receive inferior service. We believe that small retailers generally do not have access to the liquidation market because liquidation wholesalers are most often interested in liquidating large volumes of merchandise, rather than the small quantities appropriate for small, local retailers.

5

**The Overstock Solution**

Overstock provides manufacturers with a one-stop liquidation channel to sell both large and small quantities of excess and closeout inventory without disrupting sales through traditional channels. Key advantages for manufacturers liquidating their excess inventory through Overstock include:

*Resolution of channel conflict.* Channel conflicts arise when a manufacturer s excess inventory is sold through the same channel as their other product offerings. Since excess inventory is usually sold at a discount, sales of the manufacturer s other product offerings may be impacted as a consumer in a retail store may opt for the excess product or become confused by the pricing and model discrepancies. By using Overstock, manufacturers have an alternative and independent channel where they can sell excess inventory without the fear of hindering the sale of their other products.

*Single point of distribution.* Manufacturers often use multiple liquidation sources to clear their excess inventory. Multiple sources create additional logistics issues that they would rather avoid. By using Overstock, manufacturers have a single source for the distribution of excess inventory.

*Improved control of distribution.* By using Overstock, manufacturers can monitor what kind of customer, whether individual consumer or small retailer, ultimately purchases their merchandise. In addition, a manufacturer can request that its products be offered in only one of our sales channels in order to avoid sales channel pollution.

*Improved transaction experience.* By having a reliable inventory clearing channel, manufacturers are able to more quickly and easily dispense of their excess merchandise.

Overstock also offers consumers a compelling alternative for bargain shopping. Key advantages for consumers include:

*High quality and broad product selection.* Much of the merchandise offered on our Websites is from well-known, brand-name manufacturers. We typically have approximately 36,000 non-BMMG products and almost 500,000 BMMG products (books, magazines, CDs, DVDs, video cassettes and video games) in eight major departments.

*Convenient access on a secure site.* Our customers are able to access and purchase our products 24 hours a day from the convenience of their computer. We do not sell any personal information about our customer base to third parties.

*Responsive customer service and positive shopping experience*. Our team of customer service representatives (which includes employees, temporary employees and outsourced staff) assists customers by telephone, instant online chat and e-mail. Our customer service staff answers approximately 85% of phone calls within 30 seconds, and responds to approximately 98% of its e-mails within one business day. For our consumer business, we include a return shipment label in our customer s shipment to facilitate product returns and, subject to certain conditions; we allow customers up to 30 days from date of shipment to initiate the return of most purchased merchandise. In addition, we continually update and monitor our Websites to enhance the shopping experience for our customers.

Our objective is to become the dominant closeout Internet-based solution for holders of brand-name merchandise, allowing them to dispose of that merchandise discreetly and with high recovery values, and to ultimately become a one-stop Internet-based discount shopping destination. We are pursuing this objective through the following key strategies:

*Establish strong relationships with manufacturers.* With the growth in the scale of our operations, we believe we are becoming an efficient liquidation channel for manufacturers and distributors.

With scale comes the ability to buy in volume, and we believe manufacturers appreciate our ability to liquidate their products without disturbing their traditional channels. Generally, manufacturers do not want their product offerings sold as heavily discounted, closeout products in brick-and-mortar retailers, as is common today. We believe that as manufacturers learn of our capabilities, they will increasingly recognize the attractiveness of Overstock as an efficient liquidation solution.

*Optimize inventory management through the use of technology.* Our merchandise buyers are supported by proprietary software that provides information on product sales, margins and inventory levels. This technology enables us to make informed decisions and quickly change prices in an effort to maximize sales volume, gross profits and return on inventory capital.

*Optimize online marketing initiatives through the use of technology*. Our marketing team is supported by proprietary software that enhances the level of service provided to our customers and takes advantage of the unique characteristics of online distribution. Our software provides us immediate feedback on the effectiveness of various marketing campaigns, allowing us to optimize our online marketing expenditures.

*Loyalty programs.* In March 2004, we launched our frequent buyer s club, Club O. Members of Club O pay an annual fee of $29.95 and receive a 5% discount on all non-travel and non-BMMG products and $1 shipping per order, along with access to a special customer service hotline. Additionally, in November 2005, we partnered with Chase Card Services to launch an Overstock.com Co-Branded Rewards Visa credit card program, offering our customers a $30 store credit (for existing Club O members) or a free Club O membership for one year (for non-Club O members) and the opportunity to earn rewards certificates to redeem on our shopping and BMMG Websites.

**Our Business**

Overstock utilizes the Internet to create a more efficient market for liquidation merchandise. We provide consumers and businesses with quick and convenient access to high-quality, brand-name merchandise at discount prices. Our shopping business includes both a direct business and a fulfillment partner business. During the years ended December 31, 2004, 2005 and 2006, no single customer accounted for more than 1% of our total revenue. Products from our direct segment and fulfillment partner segment are available to both consumers and businesses through our Wholesale bulk purchase program.

*Direct business*

Our direct business includes sales made to individual consumers and businesses, which are fulfilled from our warehouses in Salt Lake City, Utah or our outsourced warehouses located in Plainfield, Indiana. During the years ended December, 2004, 2005 and 2006, we fulfilled approximately 40%, 38%, and 39%, respectively, of all orders through our warehouses. Our warehouses generally ship between 10,000 and 12,000 orders per day, and up to approximately 34,000 orders per day during peak periods, using overlapping daily shifts.

*Fulfillment partner business*

For our fulfillment partner business, we sell merchandise of other retailers, cataloguers or manufacturers ( fulfillment partners ) through our Website. We are considered to be the primary obligor for the majority of these sales transactions, and we assume the risk of loss on the returned items. As a consequence, we record revenue from the majority of these sales transactions involving our fulfillment partners on a gross basis. Our use of the term partner or fulfillment partner does not mean that we have formed any legal partnerships with any of our fulfillment partners. We currently have fulfillment partner relationships with approximately 540 third parties which post approximately 26,000 non-BMMG products, as well as most of the BMMG products and a portion of our current travel offerings, on our Websites.

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

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

*Wholesale business*

In August 2004, we merged our B2B site (www.overstockb2b.com) into our B2C site, and opened a Club O Gold membership program (into which our B2B customers were grandfathered). During 2005, we integrated this program into our Wholesale tab. For this tab, we have added a number of suppliers specific to various industry verticals, such as florist supplies, restaurant supplies, and office supplies.

*Travel business*

We operate a discount travel department as part of our Website. We use fulfillment partners to supply the travel products and services (flights, hotels, rental cars, etc.). We currently offer air, hotel and car reservation services as well as ski, cruise and vacation packages.

On July 1, 2005, we acquired all the outstanding capital stock of Ski West, Inc. ( Ski West ), an on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel products are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises. We paid an aggregate of $25.1 million (including $111,000 of capitalized acquisition related costs) for Ski West, and we may be subject to additional earn-out payments (based on a percentage of its operating profits for each of the four calendar years beginning with 2006 as follows: 50%, 33.3%, 20%, and 10%, respectively), subject to reduction under certain circumstances, pursuant to a Stock Purchase Agreement dated June 24, 2005, as amended to date, among us, Ski West, and all of the former shareholders of Ski West. Effective upon the closing, Ski West became our wholly-owned subsidiary, and we integrated the Ski West travel offerings with our existing travel offerings and changed its name to OTravel.com, Inc.

*Business Restructuring*

During the fourth quarter of 2006, in an effort to improve future operating performance, we commenced implementation of a facilities consolidation and restructuring program designed to reduce our overall expense structure (see Item 15 of Part IV, Financial Statements Note 4 Restructuring Expenses ). The planned actions include the termination of a co-location data center lease, marketing of the current office facilities for sub-lease, and marketing non-core businesses for sale. At December 31, 2006, we accrued a liability of $5.9 million associated with the facilities consolidation and restructuring program, including $5.5 million related to lease termination costs and $450,000 related to the asset retirement obligation (see Item 15 of Part IV, Financial Statements Note 9 Asset Retirement Obligation ), all of which is to be paid during the first quarter of 2007.

As part of this program to reduce our expense structure and sell non-core businesses, we decided during the fourth quarter of 2006 to sell the Company s travel subsidiary ( OTravel ), and we have received a non-binding letter of intent from a third-party to purchase this business. As a result, OTravel s operations have been classified as a discontinued operation and therefore are not included in the results of continuing operations. The loss from discontinued operations for OTravel was $6.9 million for the year ended December 31, 2006, including a goodwill impairment charge of $4.5 million.

*Auctions business*

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

*Cars listing business*

We operate an online site for listing cars for sale as a part of our Website. The cars listing service allows sellers to list vehicles for sale and allows buyers to review vehicle descriptions, post offers to purchase, and provides the means for purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue from our cars listing business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

*Cost of goods sold*

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

*Operating expenses*

Sales and marketing expenses consist of advertising, public relations and promotional expenditures, as well as payroll and related expenses, including stock-based compensation, for personnel engaged in marketing and selling activities. Advertising expense is the largest component of our sales and marketing expenses and is primarily attributable to expenditures related to online marketing activities and offline national radio and television advertising. For the years ended December 31, 2004, 2005 and 2006, our advertising expenses totaled approximately $39.2 million, $75.3 million and $68.1 million, respectively, representing 97%, 98% and 96%, respectively, of sales and marketing expenses.

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

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

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

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

**Key Relationships**

*Manufacturer, Supplier and Distribution Relationships.* It is difficult to establish closeout buying relationships with manufacturers. Trust and experience gained through past interactions are important. We believe our business model reduces the risk to the manufacturer that its discounted products are sold alongside its full-priced products. Our supplier relationships provide us with recognized, brand-name products. The table below identifies some of the brand names that generate significant revenues in various departments.

| | | |
|---|---|---|
| Anne Klein | Hoover | Random House |
| AOL Time Warner | Joseph Abboud | RCA |
| Bissell | JVC | Samsonite |
| Blue Ridge Home Fashions | Kodak | Seiko |
| Canon | Mai | Simon & Schuster |
| Charles David | Movado | Sony |
| Dyson | Novica | Swiss Army |
| Fuji | Panasonic | Steve Madden |
| Hewlett-Packard | Philips | Toshiba |

To date, we have not entered into contracts with manufacturers or liquidation wholesalers that guarantee the availability of merchandise for a set duration. Our manufacturer and supplier relationships are based on historical experience with manufacturers and liquidation wholesalers and do not obligate or entitle us to receive merchandise on a long-term or short-term basis. In our direct business, we purchase the products from manufacturers or liquidation wholesalers using standard purchase orders. Generally, suppliers do not control any of the terms under which products are sold over our Websites.

**Sales and Marketing**

We use a variety of methods to target our consumer audience, including online campaigns, such as advertising through portals, keywords, search engines, affiliate marketing programs, banners and e-mail campaigns, and we are able to monitor and evaluate their results. We seek to identify and eliminate campaigns that do not meet our expectations. We launched our national television and radio branding campaign in 2003, and have continued to develop it. We develop our branding campaigns internally and we believe that doing so is cost-effective.

**Products**

*Online Products*

Our products are organized into eight different product departments:

| | |
|---|---|
| Furniture | Home |
| Bedding | Sports |
| Jewelery & Watches | Electronics |
| Clothing | Entertainment |
| Other Stores | |

Each of these departments has multiple categories that more specifically define the products offered within that department. For example, the Electronics tab has the following product categories currently within the Electronics & Computers department:

| | |
|---|---|
| Audio & Video | Computers & Hardware |
| Cameras & Optics | Cellular Phones |
| Telephones | Monitors |
| Printers & Scanners | Home Office Equipment |
| New Arrivals | Clearance |

Each category has several subcategories that further detail the product contained within. For example, under the Computers & Hardware category, we have the following subcategories:

| | |
|---|---|
| Computers | PDA & Handhelds |
| Computer Accessories | Hard Drives |
| Upgrades | More |

Individual products can be accessed and viewed from the category or subcategory pages. These specific product pages include detailed product descriptions, a color picture and pricing information.

The number of total products we offer has grown from less than 100 in 1999, to more than 36,000 non-BMMG products and almost 500,000 BMMG products (books, magazines, CDs, DVDs, video cassettes and video games) as of December 31, 2006. As the number of products and product categories change throughout the year, we periodically reorganize our departments and/or categories to better reflect our current product offerings.

Our Worldstock Handcraft link found under the Other Stores tab is our socially-responsible, Internet marketplace through which artisans in the United States and around the world can sell their products and gain access to a broader market.

**Fulfillment Operations**

*General.* When customers place orders on our Websites, orders are fulfilled either by a third-party fulfillment partner or directly from our warehouses in Salt Lake City, Utah or our outsourced warehouses in Plainfield, Indiana. We monitor all of these sources for accurate order fulfillment and timely shipment. We currently charge $2.95 per order for basic ground shipping, but customers can choose from various expedited shipping services at their expense.

*Payment Terms.* Generally, we require verification of receipt of payment or credit card authorization (including verifications from BillMeLater) before we ship products to consumers or business purchasers. From time to time we grant credit to our business purchasers with normal credit terms (typically 30 days).

*Fulfillment for Direct Business.* During 2006, we fulfilled approximately 39% of all orders through our leased Salt Lake City, Utah warehouses or our outsourced warehouses in Plainfield, Indiana. During 2006, the Salt Lake City warehouse team generally shipped between 10,000 and 12,000 orders per day, and up to approximately 34,000 orders per day during peak periods, using overlapping daily shifts. We also process returns of direct and fulfillment partner merchandise in the Salt Lake City warehouse. Our warehouses store approximately 10,000 non-BMMG products offered on our Websites. We operate the Salt Lake City warehouse with an automated warehouse management system that tracks the receipt of the inventory items, distributes order-fulfillment assignments to warehouse workers and obtains rates for various shipping options to ensure low-cost outbound shipping. Our Websites relay orders to the warehouse management system throughout each day, and the warehouse management system in turn confirms to our Websites shipment of each order. Customers track the shipping status of their packages through links we provide on our Websites.

*Fulfillment Partner Business.* During 2006, approximately 61% of our orders were for inventory owned and shipped by third-party fulfillment partners. We currently manage approximately 540 entities that collect orders through our Websites. These third parties perform essentially the same operations as our warehouse: order picking and shipping; however, beginning July 1, 2003, we began handling returns for these sales. These third parties relay shipment confirmations to our Websites where customers can review shipping and tracking information. From a customer s point of view, shipping from our warehouses or from the warehouse of one of these third parties is indistinguishable.

**Customer Service**

We are committed to providing superior customer service. We staff our customer service department with dedicated in-house and outsourced professionals who respond to phone, instant online chat and e-mail inquiries on products, ordering, shipping status, and returns. Our customer service staff processes approximately 40,000 calls per week (and up to approximately 105,000 calls during peak periods).

The same staff processes approximately 30,000 e-mail messages each week (and up to approximately 70,000 e-mail messages during peak periods), with a turnaround goal of one business day. We use automated e-mail and phone systems to route traffic to appropriate customer service representatives. The demands on our customer service staff increase significantly during peak periods, including the several weeks before and after Christmas.

**Technology**

We use our internally developed Websites and a combination of proprietary technologies and commercially available licensed technologies and solutions to support our operations. We use the services of XO Communications, Inc., Qwest Communications International, Inc. and Verizon, Inc. to obtain connectivity to the Internet over multiple Gig-E and OC48 links. We currently store our data on several Oracle 10g database clusters using Dell and IBM computer hardware connected to multiple large scale EMCs for data storage. Currently, we use Dell and IBM servers for our Websites, which are connected to the Oracle database and operate in a multi-processing Linux environment designed to accommodate large volumes of Internet traffic. During 2004 we moved our primary computer infrastructure to a co-location facility in Salt Lake City.

In July 2005, we entered into a Colocation Center Agreement (the Colocation Agreement ) to build out and lease 11,289 square feet of space at Old Mill Corporate Center II in Salt Lake City for a data center and co-location facility. In November 2006, we made a determination to consolidate our facilities and began negotiations to terminate the lease of the new co-location facility (see Item 15 of Part IV Financial Statements Note 4 Restructuring Expense ), and on February 1, 2007, we terminated the lease agreement effective as of December 29, 2006. Currently, our primary computer infrastructure remains at our original co-location facility in Salt Lake City.

In addition to our co-location facility, we have computer facilities located at our principal corporate offices, which we use primarily for backups, redundancy, development, and testing. As we have made the determination to consolidate facilities, including marketing of the principal corporate office space for sub-lease, we anticipate relocating these facilities during 2007.

**Competition**

The online liquidation services market is new, rapidly evolving, intensely competitive and has relatively low barriers to entry, as new competitors can launch new Websites at relatively low cost. We believe that competition in the online liquidation market is based predominantly on:

- price;
- product quality and selection;
- shopping convenience;
- order processing and fulfillment;
- customer service; and
- brand recognition.

Our liquidation services compete with other online retailers and traditional liquidation brokers, some of which may specifically adopt our methods and target our customers. We currently or potentially compete with a variety of companies that can be divided into several broad categories:

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

As the market for online liquidation grows, we believe that companies involved in online retail, as well as traditional retailers and liquidation brokers, will increase their efforts to develop services that compete with our online services. We also face potential competition from Internet companies not yet focused on the liquidation market, and from retail companies both currently or not yet operating online. We are unable to anticipate which other companies are likely to offer services in the future that will compete with the services we provide.

In addition, many of our current and potential competitors have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do, and may enter into strategic or commercial relationships with larger, more established and well-financed companies. Some of our competitors could enter into exclusive distribution arrangements with our vendors and deny us access to their products, devote greater resources to marketing and promotional campaigns and devote substantially more resources to their Website and systems development than our company. New technologies and the continued enhancement of existing technologies also may increase competitive pressures on our company. We cannot ensure that we will be able to compete successfully against current and future competitors or address increased competitive pressures. See Item 1A Risk Factors .

**Intellectual Property**

We regard our domain names and similar intellectual property as critical to our success. We rely on a combination of laws and contractual restrictions with our employees, customers, suppliers, affiliates and others to establish and protect our proprietary rights. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without authorization. In addition, we cannot ensure that others will not independently develop similar intellectual property. Although we have registered and are pursuing the registration of our key trademarks in the United States, some of our trade names are not eligible to receive trademark protection. In addition, effective trademark protection may not be available or may not be sought by us in every country in which our products and services are made available online, including the United States.

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

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

In November 2006, the Company received a letter from Applied Interactive, claiming that certain of our business practices and our website infringe two patents owned by Applied Interactive and offering to enter into a licensing agreement. After determining that we do not infringe the patents and rejecting the offered licensing agreement, on February 2, 2007, we filed a complaint in the United States District Court, Southern District of New York, seeking declaratory judgment that we do not infringe any valid claim of the Applied Interactive patents. The complaint has been served and the case is in its initial stages. The Company intends to vigorously prosecute this action.

These and other types of claims could result in increased costs of doing business through legal expenses, adverse judgments or settlements or require us to change our business practices in expensive ways. In addition, litigation could result in interpretations of the law that require us to change our business practices or otherwise increase our costs.

Third parties have in the past, and may in the future, recruit our employees who have had access to our proprietary technologies, processes and operations. These recruiting efforts expose us to the risk that such employees will misappropriate our intellectual property.

Additional litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Any litigation, regardless of outcome or merit, could result in substantial costs and diversion of management and technical resources, any of which could materially harm our business. See Item 1A - Risk Factors .

**Government Regulation**

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

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

**Employees**

As of December 31, 2006, we had 864 full-time employees, including 194 in customer service and fraud prevention, 189 in order fulfillment, 140 in information technology and Website production, 54 in marketing, 215 in merchandising (including auctions, cars and travel), 34 in accounting and finance, and 38 in our executive and administrative department. We have never had a work stoppage, and none of our employees are represented by a labor union. We consider our employee relationships to be positive.

## ITEM 1A. RISK FACTORS

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

**Risks Relating to Overstock**

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

We have a history of losses and we may continue to incur operating and net losses for the foreseeable future. We incurred net losses attributable to common shares of $25.1 million and $101.9 million for the years ended December 31, 2005 and 2006, respectively. As of December 31, 2005 and 2006, our accumulated deficit was $96.8 million and $198.7 million, respectively. We will need to generate significant revenues to achieve profitability, and we may not be able to do so. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. If our revenues grow more slowly than we anticipate, or if our operating expenses exceed our expectations, our financial results would be harmed.

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

enhance our distribution and order fulfillment capabilities;

further improve our order processing systems and capabilities;

develop enhanced technologies and features;

expand our customer service capabilities to better serve our customers needs;

expand or modify our product offerings;

rent or terminate warehouse and office space;

increase our general and administrative functions to support our operations; and

maintain or increase our sales, branding and marketing activities, including maintaining existing or entering into new online marketing arrangements, and continuing or increasing our national television and radio branding campaigns.

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

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

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

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

At December 31, 2006, we had fulfillment partner relationships with approximately 540 third parties whose products we offer for sale on our Websites. These products accounted for approximately 72% of the non-BMMG products available. We do not have any long-term agreements with any of these third parties. Our agreements with third parties are terminable at will by either party immediately upon notice. In general, we agree to offer the third parties products on our Websites and these third parties agree to provide us with information about their products, honor our customer service policies and ship the products directly to the customer. If we do not maintain our existing or build new relationships with third parties on acceptable commercial terms, we may not be able to offer a broad selection of merchandise, and customers may refuse to shop at our Websites. In addition, manufacturers may decide not to offer particular products for sale on the Internet. If we are unable to maintain our existing or build new fulfillment partner relationships or if other product manufacturers refuse to allow their products to be sold via the Internet, our business and prospects would suffer severely.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We generally pay our senior management, including our executive officers, lower levels of cash compensation than we believe they might be able to earn elsewhere. Our stock option plan and performance share plan are intended to and do help us recruit and retain highly qualified personnel;

however, we sometimes have difficulty retaining senior level personnel. If we are unable to retain our senior management with our current compensation structure and incentive plans, we may lose members of senior management and/or be required to modify our compensation structure and/or retention plans.

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

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

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

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

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

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

- the need to develop new supplier and manufacturer relationships;
- the need to comply with additional laws and regulations to the extent applicable;
- unexpected changes in international regulatory requirements and tariffs;
- difficulties in staffing and managing foreign operations;
- longer payment cycles from credit card companies;
- greater difficulty in accounts receivable collection;
- potential adverse tax consequences;

price controls or other restrictions on foreign currency; and

difficulties in obtaining export and import licenses.

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

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

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

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

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

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

- liquidation e-tailers such as SmartBargains;

- online retailers with discount departments such as Amazon.com, Inc., eBay, Inc. and Buy.com, Inc.; and

- traditional retailers and liquidators such as Ross Stores, Inc., Walmart Stores, Inc., TJX Companies, Inc., Costco Wholesale Corporation, Target Corporation and Best Buy Co., Inc., which may or may not also have an online presence.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our Websites infringe third-party copyrights, trademarks and trade names or other intellectual property rights or that we have otherwise infringed third parties past, current or future intellectual property rights. For example, in October 2003, Tiffany (NJ) Inc. and Tiffany and Company filed a complaint against us in the United States District Court for the Southern District of New York alleging that we have distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. In addition, in January and February 2005, Tiffany filed additional complaints against us asserting similar claims. We reached a confidential agreement that settled all of these cases and all of the cases were dismissed on July 14, 2006.

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

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

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

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

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

**Prime Broker Litigation**

In February 2007, along with five shareholder plaintiffs, we filed a lawsuit in the Superior Court of California, County of San Francisco against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. The use of management s time and attention in connection with the litigation and related matters may reduce the time management is able to spend on other aspects of our business, which may have adverse effects on other aspects of our business. To the extent that any such adverse effects exceed any benefits we may realize from pursuing the litigation, our business, prospects, financial condition and results of operation may suffer.

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

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

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

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

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

**We may face risks relating to the development of our travel business.**

We acquired all of the capital stock of Ski West, Inc., an on-line travel company, on July 1, 2005 and integrated Ski West with our travel operations to form OTravel.com, Inc (our travel business). There can be no assurance about the future performance of our travel business. If we are unsuccessful in disposing of our travel business, we may encounter unforeseen operating or other difficulties.

**We may face risks relating to the planned sale of our travel business.**

In the fourth quarter of 2006, we determined to reduce our expense structure and sell non-core businesses. We have taken steps to accomplish the sale of OTravel (our travel business), and have classified it as a discontinued operation. As a result, we have implemented plans designed to reduce our travel business operating expenses and maintain its core operations at current level of performance and have discontinued plans and operations designed to expand this portion of our business. There can be no assurance that our plans to sell our travel business will succeed, or that we will achieve terms of sale favorable to us. Additionally, we may encounter problems associated with the sale which may reduce sales proceeds, cost us expenses or expose us to unanticipated litigation during or following the sale. The determination to discontinue expansion plans, and support our travel business operations at a maintenance level, may cause us to forego improvements and upgrades to its software platforms and business processes and procedures necessary to maintain a competivive operation. The sale of such a subsidiary may present these and other problems which may have a material, adverse effect on the remainder of our business operations. We may not succeed in the sale and as a result, we may have to continue operations of our travel business for some time, and may incur as a result unanticipated operational costs. We are exploring the possibility of selling some or all of our travel business. We may be unable to do so at a price equal to the price we paid for the Ski West business or at a price we consider acceptable.

**We have significant indebtedness.**

In connection with our sale of our 3.75% Convertible Senior Notes (the Senior Notes ) in November 2004, we incurred $120.0 million of indebtedness, due December 1, 2011. Under the repurchase program approved by our Board of Directors in 2005, we retired $33.0 million and $10.0 million of the Senior Notes in June and November 2005 for $27.9 million and $7.8 million in cash, respectively. As a result of the note retirements, we recognized a gain of $6.2 million for the year ended December 31, 2005, net of the associated unamortized discount of $1.2 million. As of December 31, 2006, $77.0 million of the Senior Notes remained outstanding. As a result of this indebtedness, our principal and interest payment obligations increased substantially. The degree to which we are leveraged could materially and adversely affect our ability to obtain additional financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations is dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

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

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

**Risks Relating to our Auctions Site Business**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Risks Relating to our Cars Site Business**

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

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

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

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

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

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

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

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

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

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

**Risks Relating to the Internet Industry**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

increases in the cost of advertising;

our inability to retain existing customers or encourage repeat purchases;

the extent to which our existing and future marketing agreements are successful;

price competition that results in lower profit margins or losses;

the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;

- the amount and timing of our purchases of inventory;
- our inability to manage distribution operations or provide adequate levels of customer service;
- our ability to successfully integrate operations and technologies from acquisitions or other business combinations;
- entering into new lines of products;
- our ability to attract users to our new auctions and car listing sites; and
- our inability to replace the loss of significant customers.

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

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

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

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

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

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

General Corporation Law, which could delay or prevent a change in control of our company or could impede a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company.

**Potential Stock Manipulation**

We have filed an unfair business practice lawsuit against Gradient Analytics, Rocker Partners, L.P. and others, alleging that the defendants have conspired to denigrate Overstock s business for personal profit, as well as an amended complaint alleging additional causes of action and articulating in greater detail the allegations against the defendants. We have also filed an unfair business practice lawsuit against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. We believe that the defendants in both of these lawsuits have engaged in unlawful actions and have caused substantial harm to Overstock, and that certain of the defendants have made efforts to drive the market price of Overstock s common stock down. To the extent that the defendants or other persons engage in any such actions or other take any other actions to interfere with or destroy or harm Overstock s existing and/or prospective business relationships with its suppliers, bankers, customers, lenders, investors, prospective investors or others, our business, prospects, financial condition and results of operation may suffer, and the price of our common stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of any such efforts.

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

**Available Information**

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

## **ITEM 1B.** UNRESOLVED STAFF COMMENTS

None.

**ITEM 2.** PROPERTIES

We lease approximately 154,000 square feet of office space for our corporate headquarters, customer service operations and ancilliary computer facilities in Salt Lake City, Utah. We also lease space in a co-location facility to house our primary computer infrastructure in Salt Lake City.

In July 2005, we entered into a Colocation Center Agreement (the Colocation Agreement ) to build out and lease 11,289 square feet of space at Old Mill Corporate Center II in Salt Lake City for a data center and co-location facility. In November 2006, we made a determination to consolidate our facilities and began negotiations to terminate the lease of the new co-location facility (see Item 15 Financial Statements Note 4 Restructuring Expense ), and on February 1, 2007, we terminated the lease agreement effective as of December 29, 2006. Currently, our primary computer infrastructure remains at our original co-location facility in Salt Lake City.

In addition to our co-location facility, we have computer facilities located in our principal corporate offices, which we use primarily for backups, redundancy, development, and testing. As we have made the determination to consolidate our facilities, including marketing of the principal corporate office space for sub-lease, we anticipate relocating these facilities during 2007.

We lease approximately 610,000 square feet in two warehouses and distribution facilities in Salt Lake City, Utah and approximately 540,000 square feet in two warehouses and distribution facilities in Plainfield, Indiana.

We believe that these facilities will be sufficient for our needs for the next twelve months.

## ITEM 3. LEGAL PROCEEDINGS

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

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

On August 11, 2005, along with a shareholder plaintiff, we filed a complaint against Gradient Analytics, Inc.; Rocker Partners, LP; Rocker Management, LLC; Rocker Offshore Management

Company, Inc. and their respective principals. We, along with a second shareholder plaintiff, filed the complaint in the Superior Court of California, County of Marin. On October 12, 2005, we filed an amended complaint against the same entities alleging libel, intentional interference with prospective economic advantage and violations of California s unfair business practices act. On March 7, 2006, the court denied the defendants demurrers to and motions to strike the amended complaint. The defendants each filed a motion to appeal the court s decision, we responded and the California Attorney General submitted an amicus brief supporting our view; the court has ruled that this appeal stays discovery in the case. The California Court of Appeals informed the parties that it is ready to rule on the appeal without oral argument; the defendants, however, have requested oral argument. The appeal has not yet been scheduled for oral argument. We intend to pursue this action vigorously.

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

In November 2006, we received a letter from Applied Interactive, claiming that certain of our business practices and our website infringe two patents owned by Applied Interactive and offering to enter into a licensing agreement. After determining that we do not infringe the patents and rejecting the offered licensing agreement, on February 2, 2007, we filed a complaint in the United States District Court, Southern District of New York, seeking declaratory judgment that we do not infringe any valid claim of the Applied Interactive patents. The complaint has been served and the case is in its initial stages. We intend to vigorously prosecute this action.

On February 2, 2007, along with five shareholder plaintiffs, we filed a lawsuit in the Superior Court of California, County of San Francisco against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. The suit alleges that the defendants, who control over 80% of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as fails to deliver and that the defendants actions caused and continue to cause dramatic distortions within the nature and amount of trading in our stock as well as dramatic declines in the share price of our stock. The suit asserts that a persistent large number of fails to deliver creates significant downward pressure on the price of a company s stock and that the amount of fails to deliver has exceeded 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, violations of California s Unfair Business Practices Act. We are seeking damages of $3.48 billion. The case is in its initial stages. We intend to vigorously prosecute this action.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2006.

**EXECUTIVE OFFICERS OF THE REGISTRANT**

The following persons were executive officers of Overstock.com as of March 1, 2007:

| Executive Officers | Age | Position |
|---|---|---|
| Patrick M. Byrne | 44 | Chairman, Chief Executive Officer |
| Jason C. Lindsey | 37 | President, Chief Operating Officer Director |
| Stephen P. Tryon | 45 | Senior Vice President |
| Jonathan E. Johnson III | 41 | Senior Vice President, Corporate Affairs and Legal |
| David K. Chidester | 35 | Senior Vice President, Finance |
| Stormy Simon | 38 | Senior Vice President, Customer Care, PR and Branding |

*Dr. Patrick M. Byrne* has served as our Chief Executive Officer (principal executive officer) and as a Director since October 1999, as Chairman of the Board from February 2001 through October 2005, and since July 2006. From September 1997 to May 1999, Dr. Byrne served as President and Chief Executive Officer of Fechheimer Brothers, Inc., a manufacturer and distributor of uniforms. From 1995 until its sale in September 1999, Dr. Byrne was Chairman, President and Chief Executive Officer of Centricut, LLC, a manufacturer and distributor of industrial torch parts. From 1994 to the present, Dr. Byrne has served as a Manager of the Haverford Group, an investment company and an affiliate of Overstock. Dr. Byrne has a Bachelor of Arts degree in Chinese studies from Dartmouth College, a Master s degree from Cambridge University as a Marshall Scholar, and a Ph.D. in philosophy from Stanford University.

*Jason C. Lindsey* is currently President, Chief Operating Officer and a Director of Overstock.com. He has served as a director since October 2005. He previously served as a Director from June 1999 to October 2002, and as our Chief Financial Officer from June 1999 to August 2003 and as our President from April 2003 to August 2003. From June 1998 to present, Mr. Lindsey also serves as the Controller of the Haverford Group, an investment company and an affiliate of Overstock. Prior to joining the Haverford Group, Mr. Lindsey was an auditor with PricewaterhouseCoopers LLP from January 1996 to June 1998. Mr. Lindsey has a Bachelor of Arts and a Master s degree in accounting from Utah State University.

*Mr. Tryon* joined Overstock.com in August 2004, and serves as Senior Vice President, with primary responsibility for logistics and supervision of the Company s warehouse operations. Prior to joining Overstock.com, Mr. Tryon was the Legislative Assistant to the Chief of Staff of the United States Army. During his 21 years with the Army, his assignments included director of plans for the 10th Mountain Division, Congressional Fellow for United States Senator Max Cleland, Assistant Professor of Philosophy at the United States Military Academy, and commander of a company of paratroopers. Mr.Tryon received a B.S. in Applied Sciences from the U.S. Military Academy in 1983 and a M.A. in Philosophy from Stanford University in 1992.

*Mr. Johnson* joined Overstock.com in September 2002. He has served as our General Counsel and as our Vice President, Strategic Projects, and currently serves as our Senior Vice President, Corporate Affairs and Legal and as our Secretary. From May 1999 to September 2002, Mr. Johnson held various positions with TenFold Corporation, including positions as General Counsel, Executive Vice President and Chief Financial Officer. From October 1997 to April 1999, Mr. Johnson practiced law in the Los Angeles offices of Milbank, Tweed, Hadley & McCloy and from September 1994 to September 1997, he practiced law in the Los Angeles offices of Graham & James. From February 1994 to August 1994, Mr. Johnson served as a judicial clerk at the Utah Supreme Court for Justice Leonard H. Russon, and prior to that, from August 1993 to January 1994, Mr. Johnson served as a judicial clerk at the Utah

Court of Appeals for Justice Russon. Mr. Johnson holds a Bachelor s Degree in Japanese from Brigham Young University, studied for a year at Osaka University of Foreign Studies in Japan, and received his law degree from the J. Reuben Clark, Jr. Law School at Brigham Young University.

*Mr. Chidester* served as our Controller from August 1999 to August 2003, as our Acting Chief Financial Officer from August 2003 to January 2004, and is now our Senior Vice President, Finance (our principal financial and accounting officer). Prior to joining Overstock.com, Mr. Chidester was with PricewaterhouseCoopers LLP from December 1995 to August 1999. Mr. Chidester holds a Bachelor of Science Degree in Accounting and a Master s Degree in Business Administration, both from the University of Utah.

*Ms. Simon* currently serves as our Senior Vice President, Customer Care, PR and Branding. Ms. Simon previously served as our Vice President, BMMG, Travel and Off-Line Advertising, Chief of Staff and as our Director of B2B. Prior to joining Overstock.com in 2001, Ms. Simon worked in media and travel.

There are no family relationships among any of the current officers and directors of the Company.

**PART II**

**ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock is traded on the Nasdaq Global Market under the symbol OSTK. Prior to May 30, 2002, there was no public market for our common stock. The following table sets forth, for the periods indicated, the high and low sales prices per share for our common stock as reported by Nasdaq (1).

| | Common Stock Price | |
|---|---|---|
| | **High** | **Low** |
| **Year Ended December 31, 2005** | | |
| First Quarter | 70.35 | 41.50 |
| Second Quarter | 46.25 | 33.62 |
| Third Quarter | 48.65 | 35.60 |
| Fourth Quarter | 43.40 | 28.02 |
| **Year Ended December 31, 2006** | | |
| First Quarter | 35.02 | 21.60 |
| Second Quarter | 30.63 | 19.00 |
| Third Quarter | 22.93 | 16.03 |
| Fourth Quarter | 19.09 | 13.40 |

(1) Prices shown above are sales prices. In prior reports we reported closing prices.

As of March 1, 2007, there were approximately 240 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of shareholders, we are unable to estimate the total number of shareholders represented by these record holders.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain our earnings for future growth and do not anticipate paying any cash dividends in the foreseeable future. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our results of operations, financial conditions, contractual and legal restrictions and other factors the board deems relevant. Our Loan and Security Agreement with Wells Fargo Retail Finance, LLC dated December 12, 2005 prohibits us from paying dividends without the consent of the lender.

During January 2005, the Board of Directors authorized a stock repurchase program under which the Company was authorized to repurchase up to $50.0 million of its common stock through December 31, 2007. On April 26, 2005, the Board of Directors increased the amount of the share repurchase program to $100.0 million. Additionally, on June 14, 2005, the Board of Directors authorized an amendment of its three-year stock repurchase program to include the repurchase of its Convertible Senior Notes.

During 2005, we entered into several purchased call options, pursuant to which we could have been required to purchase up to 1.3 million shares of its common stock at certain settlement dates during the quarter ended June 30, 2005. In connection with these repurchase transactions; we paid approximately $47.5 million, which was recorded in shareholders equity in the consolidated balance sheet.

At our option, the purchased call options were settled in cash or stock, based on the market price of our common stock on the date of the settlement. Upon settlement, we either had our capital investment returned with a premium or received shares of our common stock, depending, respectively, on whether the market price of our common stock was above or below a pre-determined price agreed in connection with each such transaction.

Under the share repurchase program, we repurchased approximately 665,000 shares of our common stock in open market transactions for $24.1 million during the year ended December 31, 2005. In addition, approximately 1.0 million shares of common stock were acquired as a result of the settlement of $41.1 million of structured stock repurchase transactions during the twelve months ended December 31, 2005. The purchased call options that did not settle in stock settled in cash totaling $7.9 million, which the Company received in July 2005.

We have a 401(k) defined contribution plan which permits participating employees to defer up to a maximum of 25% of their compensation, subject to limitations established by the Internal Revenue Code. Employees who have completed a half-year of service and are 21 years of age or older are qualified to participate in the plan. The Company matches 50% of the first 6% of each participant s contributions to the plan. Participant contributions are immediately vested. Company contributions vest based on the participant s years of service at 20% per year over five years. The Company s matching contribution totaled $124,000, $261,000 and $389,000 during 2004, 2005 and 2006, respectively. In addition, for the 2004, 2005 and 2006 years, the board of directors approved a 2% (of salary) profit-share contribution to all employees eligible to participate in the plan.

The Company s board of directors adopted the Amended and Restated 1999 Stock Option Plan, the 2002 Stock Option Plan and the 2005 Equity Incentive Plan (collectively, the Plans ), in May 1999, April 2002 and April 2005, respectively. Under these Plans, the Board of Directors may issue incentive stock options to employees and directors of the Company and non-qualified stock options to consultants of the Company, as well as other types of awards under the 2005 Equity Incentive Plan. Options granted under these Plans generally expire at the end of either five or ten years and vest in accordance with a vesting schedule determined by the Company s Board of Directors, usually over four years from the grant date. As of the initial public offering, the Amended and Restated 1999 Stock Option Plan was terminated. Future awards will be made under the 2005 Equity Incentive Plan. As of December 31, 2006, 1,112,000 shares were available for future grants under these Plans.

The following is a summary of stock option activity:

| | 2004 | | 2005 | | 2006 | |
|---|---|---|---|---|---|---|
| | **Shares** | **Weighted Average Exercise Price** | **Shares** | **Weighted Average Exercise Price** | **Shares** | **Weighted Average Exercise Price** |
| Outstanding beginning of year | 1,780 | $ 8.39 | 1,512 | $ 12.90 | 1,299 | $ 18.09 |
| Granted at fair value | 474 | 24.14 | 220 | 44.44 | 183 | 22.47 |
| Exercised | (468) | 6.75 | (298) | 8.56 | (276) | 9.19 |
| Canceled/forfeited | (274) | 13.26 | (135) | 24.08 | (195) | 30.17 |
| Outstanding end of year | 1,512 | 12.90 | 1,299 | 18.09 | 1,011 | 18.97 |
| Options exercisable at year-end | 608 | 7.51 | 739 | 11.33 | 679 | 15.74 |

During the last three years, except as previously reported in a Quarterly Report on Form 10-Q, Annual Report on Form 10-K or current Report on Form 8-K and amendments to those reports, the Company did not sell any equity securities that were not registered under the Securities Act.

**STOCK PERFORMANCE GRAPH**

The following graph shows a comparison of cumulative total stockholder return, calculated on a dividend reinvested basis, from the effective date of the initial public offering of Overstock s common stock (May 30, 2002) through December 31, 2006 for Overstock, Hemscott s (formerly Media General s) Nasdaq U.S. Index and Hemscott s Internet Software and Services Index. The graph assumes that $100 was invested in Overstock s common stock (at the initial public offering price of $13.00 per share), and the above indices on May 30, 2002. Historic stock price performance is not necessarily indicative of future stock price performance.

**ITEM 6.** SELECTED FINANCIAL DATA

The following selected consolidated financial data as of December 31, 2005 and 2006 and for each of the three years in the period ended December 31, 2006, are derived from our consolidated financial statements and are included elsewhere in this Form 10-K/A. The consolidated financial data as of December 31, 2002, 2003 and 2004 and for the years ended December 31, 2002 and 2003, are derived from audited consolidated financial statements, but are not contained herein. The historical results do not necessarily indicate results expected for any future period. This information should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and the related notes thereto included elsewhere in this Form 10-K/A.

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | **2002** | **2003** | **2004** | **2005** | **2006(1)** |
| | (in thousands, except per share data) | | | | |
| **Consolidated Statement of Operations Data:** | | | | | |
| Revenue | | | | | |
| Direct revenue | $ 79,405 | $ 138,134 | $ 213,210 | $ 324,875 | $ 303,202 |
| Fulfillment partner revenue | 12,379 | 100,811 | 281,425 | 474,441 | 484,948 |
| Total revenue | 91,784 | 238,945 | 494,635 | 799,316 | 788,150 |
| Cost of goods sold | | | | | |
| Direct | 70,736 | 124,039 | 184,964 | 282,383 | 284,943 |
| Fulfillment partner | 2,755 | 89,190 | 243,468 | 400,057 | 408,407 |
| Total cost of goods sold | 73,491 | 213,229 | 428,432 | 682,440 | 693,350 |
| Gross profit | 18,293 | 25,716 | 66,203 | 116,876 | 94,800 |
| Operating expenses: | | | | | |
| Sales and marketing | 8,881 | 20,228 | 40,559 | 77,155 | 70,897 |
| Technology | 2,404 | 2,549 | 8,509 | 27,901 | 65,158 |
| General and administrative | 10,821 | 14,987 | 22,024 | 33,043 | 46,837 |
| Restructuring(2) | | | | | 5,674 |
| Total operating expenses | 22,106 | 37,764 | 71,092 | 138,099 | 188,566 |
| Operating loss | (3,813) | (12,048) | (4,889) | (21,223) | (93,766) |
| Interest income, net | 403 | 461 | 1,173 | (270) | 3,566 |
| Interest expense | (465) | (76) | (775) | (5,582) | (4,765) |
| Other (expense) income, net | (444) | 115 | (49) | 4,728 | 81 |
| Loss from continuing operations | (4,319) | (11,548) | (4,540) | (22,347) | (94,884) |
| Discontinued operations(3): | | | | | |
| Loss from discontinued operations | | | | (2,571) | (6,882) |
| Net loss | (4,319) | (11,548) | (4,540) | (24,918) | (101,766) |
| Deemed dividend related to redeemable common stock | (406) | (262) | (188) | (185) | (99) |
| Deemed dividend related to beneficial conversion feature of preferred stock | (6,607) | | | | |
| Net loss attributable to common shares | $ (11,332) | $ (11,810) | $ (4,728) | $ (25,103) | $ (101,865) |
| Net loss per common share basic and diluted | | | | | |
| Loss from continuing operations | $ (0.86) | $ (0.73) | $ (0.26) | $ (1.16) | $ (4.67) |
| Loss from discontinued operations | | | | $ (0.13) | $ (0.34) |
| Net loss per common share basic and diluted | $ (0.86) | $ (0.73) | $ (0.26) | $ (1.29) | $ (5.01) |
| Weighted average common shares outstanding basic and diluted | 13,108 | 16,198 | 17,846 | 19,429 | 20,332 |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| | | | (in thousands) | | |
| Balance Sheet Data: | | | | | |
| Cash and cash equivalents | $ 11,059 | $ 28,846 | $ 198,678 | $ 55,875 | $ 126,965 |
| Marketable securities | 21,603 | 11,500 | 88,802 | 55,799 | |
| Working capital | 36,157 | 46,101 | 267,947 | 80,162 | 65,072 |
| Total assets | 64,434 | 98,549 | 377,543 | 325,913 | 256,165 |
| Total indebtedness | 182 | 161 | 117,589 | 84,676 | 84,336 |
| Redeemable common stock | 4,363 | 2,978 | 3,166 | 3,205 | |
| Stockholders equity | 39,749 | 55,731 | 169,811 | 89,749 | 61,964 |

(1) Effective January 1, 2006, we adopted SFAS 123(R). We recognized stock-based compensation of $4.1 million in 2006.

(2) During the fourth quarter of 2006, we commenced implementation of a facilities consolidation and restructuring program designed to reduce the overall expense structure in an effort to improve future operating performance (Item 15 of Part IV, Financial Statements Note 4 Restructuring Expense ). The planned actions include the termination of a co-location data center lease, marketing of the current office facilities for sub-lease and marketing non-core businesses for sale.

(3) As part of the program to reduce our expense structure and sell non-core businesses, we decided during the fourth quarter of 2006 to sell our travel subsidiary ( OTravel ) , and we have received a non-binding letter of intent from a third-party to purchase this business. As a result, OTravel s operations have been classified as a discontinued operation and therefore are not included in the results of continuing operations.The loss from discontinued operations for OTravel was $6.9 million for the year ended December 31, 2006, including a goodwill impairment charge of $4.5 million.

## ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

*The following Management s Discussion and Analysis of Financial Condition and Results of Operation should be read in conjunction with our Consolidated Financial Statements and the related Notes thereto. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions, as set forth under Special Note Regarding Forward-Looking Statements. Our actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of several factors, including those set forth in the following discussion and under Risk Factors and elsewhere in this Form 10-K/A.*

**Recent Developments**

During the fourth quarter of 2006, in an effort to improve future operating performance, we commenced implementation of a facilities consolidation and restructuring program designed to reduce our overall expense structure (see Item 15 of Part IV, Financial Statements Note 4 Restructuring Expense ). The planned actions include the termination of a co-location data center lease, marketing of the current office facilities for sub-lease, and marketing non-core businesses for sale. At December 31, 2006, we accrued a liability of $5.9 million associated with the termination of the co-location data center lease and other costs related to our facilities consolidation plan, including $5.5 million related to lease termination costs and $450,000 related to the asset retirement obligation (see Item 15 of Part IV, Financial Statements Note 9 Asset Retirement Obligation ).

As part of this program to reduce our expense structure and sell non-core businesses, we decided during the fourth quarter of 2006 to sell our travel subsidiary ( OTravel ), and we have received a non-binding letter of intent from a third-party to purchase this business. As a result, OTravel s operations have been classified as a discontinued operation and therefore are not included in the results of continuing operations. The loss from discontinued operations for OTravel was $6.9 million for the year ended December 31, 2006, including a goodwill impairment charge of $4.5 million.

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

**Overview**

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

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

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

**Our Business**

Overstock utilizes the Internet to create a more efficient market for liquidation merchandise. We provide consumers and businesses with quick and convenient access to high-quality, brand-name merchandise at discount prices. Our shopping business includes both a direct business and a fulfillment partner business. During the year ended December 31, 2006, no single customer accounted for more than 1% of our total revenue. Products from our direct segment and fulfillment partner segment are available to both consumers and businesses through our Wholesale bulk purchase program.

*Direct business*

Our direct business includes sales made to individual consumers and businesses, which are fulfilled from our warehouses in Salt Lake City, Utah or our outsourced warehouses located in Plainfield, Indiana. During the year ended December 31, 2006, we fulfilled approximately 39% of all orders through our warehouses. Our warehouses generally ship between 10,000 and 12,000 orders per day, and up to approximately 34,000 orders per day during peak periods, using overlapping daily shifts.

*Fulfillment partner business*

For our fulfillment partner business, we sell merchandise of other retailers, cataloguers or manufacturers ( fulfillment partners ) through our Website. We are considered to be the primary obligor for the majority of these sales transactions, and we assume the risk of loss on the returned items. As a consequence, we record revenue from the majority of these sales transactions involving our fulfillment partners on a gross basis. Our use of the term partner or fulfillment partner does not mean that we have formed any legal partnerships with any of our fulfillment partners. We currently have fulfillment partner relationships with approximately 540 third parties which post approximately 26,000 non-BMMG products, as well as most of the BMMG products and a portion of our current travel offerings, on our Websites.

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

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

*Wholesale business*

In August 2004, we merged our B2B site (www.overstockb2b.com) into our B2C site, and opened a Club O Gold membership program (into which our B2B customers were grandfathered). During 2005, we integrated this program into our Wholesale tab. For this tab, we have added a number of suppliers specific to various industry verticals, such as florist supplies, restaurant supplies, and office supplies.

*Travel business*

We operate a discount travel department as part of our Website. We use fulfillment partners to supply the travel products and services (flights, hotels, rental cars, etc.). We currently offer air, hotel and car reservation services as well as ski, cruise and vacation packages.

On July 1, 2005, we acquired all the outstanding capital stock of Ski West, Inc. ( Ski West ), an on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel products are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises. We paid an aggregate of $25.1 million (including $111,000 of capitalized acquisition related costs) for Ski West, and we may be subject to additional earn-out payments (based on a percentage of operating profits for each of the four calendar years beginning with 2006 as follows: 50%, 33.3%, 20%, and 10%, respectively), subject to reduction under certain circumstances, pursuant to a Stock Purchase Agreement dated June 24, 2005, as amended to date, among us, Ski West, and all of the former shareholders of Ski West. Effective upon the closing, Ski West became our wholly-owned subsidiary, and we integrated the Ski West travel offerings with our existing travel offerings and changed its name to OTravel.com, Inc.

As part of a program to reduce our expense structure and sell non-core businesses, we decided during the fourth quarter of 2006 to sell OTravel, and we have received a non-binding letter of intent from a third-party to purchase this business (see Item 15 of Part IV, Financial Statements Note 5 Acquisition and Subsequent Discontinued Operations ).

*Auctions business*

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

*Cars listing business*

We operate an online site for listing cars for sale as a part of our Website. The cars listing service allows sellers to list vehicles for sale and allows buyers to review vehicle descriptions, post offers to purchase, and provides the means for purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue from our cars listing business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

*Cost of goods sold*

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

*Operating expenses*

Sales and marketing expenses consist primarily of advertising, public relations and promotional expenditures, as well as payroll and related expenses, including stock-based compensation, for personnel engaged in marketing and selling activities. Advertising expense is the largest component of our sales and marketing expenses and is primarily attributable to expenditures related to online marketing activities and offline national radio and television advertising. For the years ended December 31, 2005 and 2006, our advertising expenses totaled approximately $75.3 million and $68.1 million, respectively, representing 98% and 96%, respectively, of sales and marketing expenses.

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

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

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

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

**Executive Commentary**

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

*Commentary Revenue Decrease and Website Conversion.* Our fourth quarter revenue declined 7%, the same percentage decline we experienced in Q3, and our annual revenue was down 1%. We believe that these decreases were primarily the result of our infrastructure upgrades in the last half of 2005, which resulted in an unsatisfactory shopping experience for many of our customers and affected both repeat and new customer revenue in 2006. We believe that a key to future revenue growth is to increase our Website conversion rate defined as the percentage of visitors to the website who make a purchase. The areas of our business that most directly affect conversion rate, including personalization of the website, customer retention, e-mail marketing, and site design and layout, are the responsibility of our internal marketing department. Within each of these areas, we have identified and made progress on initiatives that we believe can improve conversion. We have also outsourced to third-party providers certain aspects of the functionality on the website, including the engine that provides product recommendations to customers visiting product pages and the gift center that went live during the fourth quarter.

*Commentary Operations Summary.* We made significant improvements to our operations in 2006. We continue to closely measure and reduce customer aggravation points within our order process. In addition, we have seen cost improvements over the course of the year in both warehouse handling and customer service costs. We believe these improvements have improved the overall customer shopping experience, and believe that this is evidenced by our continued high reported Net Promoter Score ( NPS ). Also, our new systems easily handled the fourth quarter volume this year.

*Commentary  Gross Margins.* We consciously and aggressively discounted older inventory during the fourth quarter, and as a result, our direct gross margins were negatively impacted. However, we did this to significantly clean and reduce our inventory in an effort to reduce the overall SKU (stock keeping unit) count on our website and to refine our product selection to categories that turn faster and have higher profitability.  We believe that we can run our direct business with less inventory than we have had in the past, while filling in product selection using fulfillment partners, rather than acquiring the inventory directly. As a result of these efforts, we believe that we should see a significant improvement in direct and overall gross margins beginning in the first quarter of 2007. With reduced inventory levels, we now have excess warehouse capacity, and we are therefore making efforts to reduce warehouse space. We believe that we will see additional improvement to direct gross margins if and when we are able to successfully do this.

*Commentary  Marketing.* Our intent in 2006 was to keep marketing expense as a percent of sales at approximately 7%, and we had accomplished this over the first six months of the year. We entered the third quarter with our systems and processes running smoothly, and our customer satisfaction ratings back to where they had been prior to the system issues we experienced at the end of 2005. As a result, we increased both online and offline marketing expenditures in the last half of 2006 in an effort to create sales momentum in Q4 2006 and into 2007. However, we did not see a corresponding increase in revenue, primarily as a result of visitor conversion rates, and marketing expense ended at 9% of sales for the year.

We believe that our marketing expenditures were also less efficient due to overall increases in online marketing rates, as well as the expiration of marketing  agreements we had with several large portals, including MSN, Yahoo and AOL, which are either no longer available or are too expensive for us to justify. In an effort to offset this, we have internally developed a search engine optimization tool that we believe will help us manage keyword purchases more efficiently. We intend to reduce our marketing expenditures as a percent of sales in 2007 below the 9% we spent in 2006.

*Commentary  Technology and G&A costs.* Through 2004, we were growing rapidly (over 80% year-over-year) and had reached $495 million in revenue, yet we had invested less than $25 million into our systems and infrastructure. We believed that we would continue to see rapid growth and therefore made significant investments into our facilities, system infrastructure and warehouse space, just as sales growth stopped. As a result, our expense structure is higher than is necessary for our current revenue level, and therefore we have begun efforts to decrease our operating expenses. We have reduced our headcount from 864 at December 2006 to 725 at February 2007. We have terminated an expensive computer co-location facility lease. We are in the process of significantly reducing additional facilities and warehouse lease costs and other expenses. Among other things, we intend to move our corporate offices into existing space in our main Salt Lake City warehouse. As a result of these efforts, we expect our technology and G&A costs to decrease in 2007.

*Commentary  Balance Sheet Items* We ended 2006 with $20 million of inventory, significantly lower than the $93 million we had at the end of 2005. From this lower inventory level, we expect to turn our inventory much more efficiently. We have entered 2007 with more attractive, higher margin inventory, and as a result, we expect our gross margins in 2007 to increase significantly over 2006 levels. In addition to converting much of our inventory into cash, we also raised $40 million in common equity in December (for a total of $64 million in common equity raised during 2006), greatly improving our cash position, which ended the year at $127 million. At current inventory levels, we anticipate that we may require less capital to run our business in 2007. However, whether we will need to raise additional capital will depend on, among other things, our revenues, gross margins, product sales mix and expenses.

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

**Critical Accounting Policies and Estimates**

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

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

*Revenue recognition.* We derive our revenue primarily from two sources: (i) direct revenue, which consists of merchandise sales made to consumers and businesses that are fulfilled from our warehouses; and (ii) fulfillment partner revenue, which consists of revenue from the sale of merchandise supplied and shipped by fulfillment partners directly to consumers and other businesses. This also includes listing fees and commissions collected from products being listed and sold through the Auctions tab of our Website as well as advertisement revenue derived from our cars listing business. All sources of revenue are recorded net of returns, coupons redeemed by customers, and other discounts. Revenues from our auction services were not material in 2004, 2005 and 2006 and therefore are included in fulfillment partner revenue.

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

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

*Reserve for returns, allowance for doubtful accounts and the reserve for obsolete and damaged inventory.* Our management must make estimates of potential future product returns related to current period revenue. Management analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns reserve and other allowances in any accounting period. The reserve for returns was $5.6 million and $3.6 million as of December 31, 2005 and 2006, respectively.

From time to time, we may grant credit to certain of our business customers on normal credit terms (typically 30 days). We perform ongoing credit evaluations of our customers financial condition and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectibility of all accounts receivable. We maintained an allowance for doubtful accounts receivable of $1.8 million and $2.1 million as of December 31, 2005 and 2006, respectively.

We write down our inventory for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory reserve represents the new cost basis of such products. Reversal of these reserves is recognized only when the related inventory has been sold or scrapped. At December 31, 2005, our inventory balance was $93.3 million, net of reserve for obsolescence or damaged inventory of $5.2 million. As of December 31, 2006, our inventory balance was $20.3 million, net of allowance for obsolescence or damaged inventory of $6.6 million.

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

During the years ended December 31, 2005 and 2006, we capitalized $24.4 million and $15.0 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $3.9 million and $14.6 million for those respective periods.

*Accounting for income taxes.* Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. As of December 31, 2005 and 2006, we have recorded a full valuation allowance of $36.6 million and $74.4 million, respectively, against our net deferred tax asset balance due to uncertainties related to our deferred tax assets as a result of our history of operating losses. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to change the valuation allowance, which could materially impact our financial position and results of operations.

*Valuation of long-lived and intangible assets and goodwill.* Under SFAS 142, *Goodwill and Other Intangible Assets*, goodwill is not amortized, but must be tested for impairment at least annually. Other long-lived assets must also be evaluated for impairment when management believes that an asset has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the asset that may not be reflected in an asset s current carrying value, thereby possibly requiring an impairment charge in the future. Goodwill totaled $2.8 million as of December 31, 2005 and 2006. There was no impairment of goodwill or long-lived assets during the year ended December 31, 2005. In conjunction with the decision to sell OTravel, our travel subsidiary, we performed an evaluation of its goodwill , pursuant to SFAS 144, *Accounting for the Impairment Long-Lived Assets*, and SFAS 142, *Goodwill and Other*

*Intangible Assets,* and determined that goodwill was subject to an impairment loss of approximately $4.5 million in the year ended December 31, 2006.

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

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

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

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

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

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

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

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

As of December 31, 2006, the Company has accrued $900,000 in total compensation expense under the performance share plan which is included in general and administrative expenses.

*Recent Accounting Pronouncements.*

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

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109, (FIN 48). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. FIN 48 is effective for us on January 1, 2007. We are currently evaluating the impact of this interpretation and do not expect the adoption of FIN 48 to have a material impact on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (SAB 108). SAB 108 was issued to provide interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The provisions of SAB 108 are effective for us for the December 31, 2006 year-end. The adoption of SAB 108 did not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements. SFAS 157 becomes effective for us on January 1, 2008. Upon adoption, the provisions of SFAS 157 are to be applied prospectively with limited exceptions. We do not expect the adoption of SFAS 157 to have a material impact on our consolidated financial statements.

**Results of Operations**

The following table sets forth our results of operations expressed as a percentage of total revenue for 2004, 2005 and 2006.

| | Years ended December 31, | | |
|---|---|---|---|
| | **2004** | **2005** | **2006** |
| | | **(as a percentage of total revenue)** | |
| Revenue | | | |
| Direct revenue | 43.1% | 40.6% | 38.5% |
| Fulfillment partner revenue | 56.9 | 59.4 | 61.5 |
| Total revenue | 100.0 | 100.0 | 100.0 |
| Cost of goods sold | | | |
| Direct | 37.4 | 35.3 | 36.2 |
| Fulfillment partner | 49.2 | 50.1 | 51.8 |
| Total cost of goods sold | 86.6 | 85.4 | 88.0 |
| Gross profit | 13.4 | 14.6 | 12.0 |
| Operating expenses: | | | |
| Sales and marketing | 8.2 | 9.7 | 9.0 |
| Technology | 1.7 | 3.5 | 8.3 |
| General and administrative | 4.5 | 4.1 | 5.9 |
| Restructuring | | | 0.7 |
| Total operating expenses | 14.4 | 17.3 | 23.9 |
| Operating loss | (1.0) | (2.7) | (11.9) |
| Interest income, net | 0.2 | (0.0) | 0.5 |
| Interest expense | (0.1) | (0.7) | (0.6) |
| Other (expense) income, net | (0.0) | 0.6 | 0.0 |
| Loss from continuing operations | (0.9)% | (2.8)% | (12.0)% |

**Comparison of Years Ended December 31, 2005 and 2006**

**Revenue**

During the year ended December 31, 2005 and 2006, total revenue decreased 1%, from $799.3 million in 2005 to $788.2 million in 2006. During the same period, direct revenue decreased 7%, from $324.9 million in 2005 to $303.2 million in 2006, while fulfillment partner revenue experienced 2% growth, from $474.4 million in 2005 to $484.9 million in 2006.

Our fourth quarter revenue declined 7%, the same percentage decline we experienced in Q3, and total revenue was down 1% for the year. We believe that these decreases were primarily the result of our infrastructure upgrades in the last half of 2005, which resulted in an unsatisfactory shopping experience for many of our customers and affected both repeat and new customer sales in 2006. We believe that a key to future revenue growth is to increase our Website conversion rate defined as the percentage of visitors to the website who make a purchase. The areas of our business that most directly affect conversion rate, including personalization of the website, customer retention, e-mail marketing, and site design and layout, are the responsibility of our internal marketing department. Within each of these areas, we have identified and made progress on initiatives that we believe can improve conversion, including outsourcing to third-party providers certain aspects of the functionality on the website, such as the engine that provides product recommendations to customers visiting product pages and the gift center that went live during the fourth quarter.

**Gross Margins**

Total Gross Margins For the years ended December 31, 2005 and 2006, total cost of goods sold increased $10.9 million or 2%, from $682.4 million in 2005 to $693.4 in 2006, resulting in a decrease in gross profits of 19% (from $116.9 million in 2005 to $94.8 million in 2006) during the same periods. As a percent of total revenue, cost of goods sold increased from 85% to 88% for those respective periods, resulting in decreased gross margins of 14.6% and 12.0% for the years ended December 31, 2005 and 2006, respectively. Cost of goods sold also included stock-based compensation related to the adoption of SFAS 123(R) in 2006 of $412,000 during the year ended December 31, 2006 compared to $6,000 of stock-based compensation in 2005.

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

Direct Gross Margins For the years ended December 31, 2005 and 2006, gross profits for our direct business decreased 57% from $42.5 million in 2005 to $18.3 million in 2006. Gross margins for our direct business decreased from 13.1% to 6.0% for those respective periods. The lower gross margins experienced by the direct business are primarily the result of lowering prices to our customers in an effort to significantly reduce inventory levels, which decreased from $93.3 million at the end of 2005 to $20.3 million at the end of 2006. As a result, we anticipate that we will see significant improvements in our direct gross margins in 2007, particulary if we are able to successfully reduce warehouse space.

Fulfillment Partner Gross Margins For the years ended December 31, 2005 and 2006, our fulfillment partner business generated gross profits of $74.4 million and $76.5 million, respectively, an increase of 3%, also resulting in increased gross margins of 15.7% and 15.8% for those respective periods.

**Fulfillment costs**

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

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

| | Year ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | 2004 | | | 2005 | | | 2006 | |
| Total revenue | $ | 494,635 | 100% | $ | 799,316 | 100% | $ | 788,150 | 100% |
| Cost of goods sold | | | | | | | | | |
| Product costs and other cost of goods sold | | 394,154 | 80% | | 622,509 | 78% | | 632,494 | 80% |
| Fulfillment costs | | 34,278 | 7% | | 59,931 | 7% | | 60,856 | 8% |
| Total cost of goods sold | | 428,432 | 87% | | 682,440 | 85% | | 693,350 | 88% |
| Gross profit | $ | 66,203 | 13% | $ | 116,876 | 15% | $ | 94,800 | 12% |

As displayed in the above table, fulfillment costs during the years ended December 31, 2004, 2005 and 2006 were $34.3 million, $59.9 million and $60.9 million, respectively, or 6.9%, 7.5% and 7.7% of total revenue for those respective periods. Fulfillment costs as a percentage of sales may vary due to several factors, such as our ability to manage costs at our warehouses, significant changes in the number of units received and fulfilled, the extent we utilize third party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees.

**Operating expenses**

*Sales and marketing.* For the years ended December 31, 2005 and 2006, sales and marketing expenses totaled $77.2 million and $70.9 million (8% decrease), respectively. As a percentage of total revenue, sales and marketing expenses decreased slightly from 10% in 2005 to 9% in 2006. We direct customers to our Websites primarily through a number of targeted online marketing channels, such as sponsored search, affiliate marketing, portal advertising, e-mail campaigns, and other initiatives. We also utilize channels such as nation-wide television, print and radio advertising campaigns. Our marketing expense is variable and is measured as a percentage of overall sales.

Our intent in 2006 was to keep marketing expense as a percent of sales at approximately 7%, and we had accomplished this over the first six months of the year. However, we entered the third quarter with our systems and processes running smoothly, and our customer satisfaction ratings back to where they had been prior to the system issues we experienced at the end of 2005. As a result, we increased both online and offline marketing expenditures in the last half of 2006 in an effort to create sales momentum in Q4 2006 and into 2007. However, we did not see a corresponding increase in sales, primarily as a result of visitor conversion rates, and marketing expense was 10% of sales in the fourth quarter, bringing it to 9% of sales for the year.

We believe that our marketing expenditures were less efficient due to overall increases in online marketing rates, as well as the expiration of marketing agreements that we had with several large portals, including MSN, Yahoo and AOL, which are either no longer available or are too expensive for us to justify. In an effort to offset this, we have internally developed a search engine optimization tool that we believe will help us manage keyword purchases more efficiently. We intend to reduce marketing expenditures as a percent of sales in 2007, and we currently have multiple projects in development that are intended to help improve conversion rates and our overall marketing efficiency.

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

Sales and marketing expenses also included stock-based compensation related to the adoption of SFAS 123(R) in 2006 of $301,000 during the year ended December 31, 2006 compared to $4,000 of stock-based compensation in 2005.

*Technology expenses.* Technology expenses increased 134%, from $27.9 million for the year ended December 31, 2005 to $65.2 million for the same period in 2006, representing 3% and 8% of total revenue for those respective periods. Technology expenses also included stock-based compensation related to the adoption of SFAS 123(R) in 2006 of $684,000 during the year ended December 31, 2006, compared to $11,000 of stock-based compensation in 2005.

We have incurred a stair-step increase in technology costs over the past two years, as we have made significant investments in all of our major systems, with approximately $60 million of capital expenditures in 2005 and an additional $26 million in 2006 (including increases to capital leases). The increases in expense are related primarily to increased depreciation expense, as well as increases in maintenance and support costs, and increased IT personnel, including consultants. These increased expenses resulted in a significant increase in technology expenses as a percent of sales for the full-year 2006. However, we plan to reduce capital expenditures to $10 million or less in 2007, and we believe that overall technology costs will begin to decrease going forward.

*General and administrative expenses.* General and administrative ( G&A ) expenses increased 42%, from $33.0 million during the year ended December 31, 2005 to $46.8 million during the same period in 2006, representing 4% and 6% of total revenue for each of the respective periods. We incurred stock-based compensation within general and administrative expenses of approximately $2.7 million for the year ended December 31, 2006 compared to $51,000 in stock-based compensation in 2005.

The increase in G&A expenses in 2006 compared to 2005 relates to increases in payroll-related expenses, professional fees, merchandising, legal and finance costs, and also due to increased costs related to our relocation of our corporate offices to larger facilities in the third quarter of 2005. However, in our efforts to cut costs, our current office space is being marketed for sublease, and we plan to move our corporate offices into existing space in our main Salt Lake City warehouse during 2007. We believe that overall our G&A costs will decrease in 2007.

A large portion of our technology and general and administrative expenses are now non-cash expenses. Total depreciation and amortization (including amortization of stock-based compensation) in 2006 was $36 million, and we estimate that total depreciation and amortization in 2007 will be approximately $35 million. This compares to only $14 million of similar non-cash expenses in 2005.

*Restructuring expenses.* During the fourth quarter of 2006, in an effort to improve future operating performance, we commenced implementation of a facilities consolidation and restructuring program designed to reduce our overall expense structure (see Item 15 of Part IV, Financial Statements Note 4 Restructuring Expense ). The planned actions include the termination of a co-location data center lease, marketing of the current office facilities for sub-lease, and marketing non-core businesses for sale. Of the $5.7 million of charges related to the facilities consolidation and restructuring program, $4.6 million relates to technology expenses and $1.1 million relates to general and administrative expenses. At December 31, 2006, we accrued a liability of $5.9 million associated with the facilities consolidation and reconstructuring program, including $5.5 million related to lease termination costs and $450,000 related to asset retirement obligation, all of which is to be paid during the first quarter of 2007.

**Non-operating income (expense)**

*Interest income, interest expense and other income (expense).* Interest income is derived from the investment of our excess cash in short-term investments and marketable securities. In 2005, we incurred a large expense related to the valuation of the conditional coupon of our foreign bonds. Consequentially, interest income increased from $270,000 negative interest income related to a decrease in the valuation of the conditional coupon of our foreign bonds in 2005, to a positive $3.6 million of interest income for the year ended December 31, 2006, including a $1.9 million gain recognized in 2006 as a result of selling the foreign bonds.

Interest expense is largely related to our convertible notes, capital leases and our credit lines. Interest expense decreased slightly from $5.6 million during the year ended December 31, 2005 to $4.8 million during the same period in 2006. The decrease in interest expense is related to the reduction of convertible notes outstanding related to the retirement of $43.0 million of Senior Notes in June and November of 2005. See Item 15 of Part IV, Financial Statements Note 13 3.75% Convertible Senior Notes .

Under SFAS No. 133, the Foreign Notes were considered to be derivative financial instruments and were marked to market quarterly. Any unrealized gain or loss related to the changes in value of the conditional coupon was recorded in the income statement as a component of interest income or expense. Any unrealized gain or loss related to the changes in the value of the Notes was recorded as a component of other comprehensive income (loss). On April 26, 2006, we sold the Foreign Notes for $49.5 million, resulting in the gain on the bond instrument of $1.9 million. See Item 15 of Part IV, Financial Statements Note 6 Marketable Securities .

Other income for the year ended December 31, 2005 relates primarily to the retirement of $43.0 million of Senior Notes for $35.7 million, which resulted in a recognized gain of $6.2 million.

**Discontinued operations**

As part of the program to reduce our expense structure and sell non-core businesses, we decided during the fourth quarter of 2006 to sell our travel subsidiary ( OTravel ) , and we have received a non-binding letter of intent from a third-party to purchase this business. As a result, OTravel s operations have been classified as a discontinued operation and therefore are not included in the results of continuing operations. The loss from discontinued operations for OTravel was $6.9 million for the year ended December 31, 2006, including a goodwill impairment charge of $4.5 million.

**Income taxes**

*Income taxes.* For the year ended December 31, 2005 and 2006, we incurred net operating losses, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2005 and 2006, we had net operating loss carryforwards of approximately $58.0 million and $145.2 million, respectively, which may be used to offset future taxable income. An additional $21.9 million of net operating losses are limited under Internal Revenue

Code Section 382 to $799,000 a year. These net operating loss carryforwards will begin to expire in 2018.

**Supplemental Information about Stock-Based Compensation**

***Periods prior to the adoption of SFAS 123(R)***

Prior to January 1, 2006, the Company accounted for stock-based awards under the intrinsic value method, which followed the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employee*,and related interpretations. The intrinsic value method of accounting resulted in compensation expense for stock options to the extent option exercise prices were set below market prices on the date of grant. Also, to the extent stock awards were forfeited prior to vesting, any previously recognized expense was reversed as an offset to operating expenses in the period of forfeiture.

The following table illustrates the effects on net loss and net loss per share as if the Company had applied the fair value recognition provisions of SFAS 123, *Accounting for Stock Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* to options granted under the Company s stock-based compensation plans prior to the adoption. For purposes of this pro forma disclosure, the value of the options was estimated using the Black-Scholes-Merton ( BSM ) option-pricing formula and amortized on a straight-line basis over the respective vesting periods of the awards. Disclosure for the year ended December 31, 2006 is not presented because stock-based payments were accounted for under SFAS 123 (R) s fair value method during this period.

| | Year ended December 31, | | | |
|---|---|---|---|---|
| | | **2004** | | **2005** |
| Net loss, as reported | $ | (4,540) | $ | (24,918) |
| Add: Stock-based employee compensation, as reported | | 360 | | 72 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards | | (3,747) | | (3,996) |
| Pro forma net loss | $ | (7,927) | $ | (28,842) |
| Net loss per common share | | | | |
| Basic and diluted as reported | $ | (0.26) | $ | (1.29) |
| Basic and diluted pro forma | $ | (0.44) | $ | (1.48) |

***Adoption of SFAS 123(R)***

As of January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method, which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The fair value of stock options is determined using the BSM valuation model, which is consistent with our valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123. Such value is recognized as expense over the service period, net of estimated forfeitures, using the straight-line method under SFAS 123(R).

The adoption of SFAS 123(R) did not result in a cumulative benefit from accounting change, which reflects the net cumulative impact of estimating future forfeitures in the determination of period expense, rather than recording forfeitures when they occur as previously permitted, as we did not have unvested employee stock awards for which compensation expense was recognized prior to adoption of SFAS No. 123(R).

Prior to the adoption of SFAS 123(R), cash retained as a result of tax deductions relating to stock-based compensation was presented in operating cash flows, along with other tax cash flows, in accordance with the provisions of the Emerging Issues Task Force ( EITF ) Issue No. 00-15, *Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option.* SFAS 123(R) supersedes EITF 00-15, amends SFAS 95, *Statement of Cash Flows,* and requires tax benefits relating to excess stock-based compensation deductions to be prospectively presented in the statement of cash flows as financing cash inflows. As of the adoption of SFAS 123(R), we had fully reserved against any tax benefits resulting from stock-based compensation deductions in excess of amounts reported for financial reporting purposes.

On March 29, 2005, the SEC published Staff Accounting Bulletin ( SAB ) No. 107, which provides the Staff s views on a variety of matters relating to stock-based payments. SAB 107 requires stock-based compensation be classified in the same expense line items as cash compensation. The Company has reclassified stock-based compensation from prior periods to correspond to current period presentation within the same operating expense line items as cash compensation paid to employees.

The application of SFAS 123(R) had the following effect on the year ended December 31, 2006 reported amounts relative to amounts that would have been reported using the intrinsic value method under previous accounting (in thousands, except per share amounts):

| SFAS 123(R) Adjustments | | Year ended December 31, 2006 |
|---|---|---|
| Operating loss | $ | (4,120) |
| Net loss | $ | (4,120) |
| Net loss per common share basic and diluted | $ | (0.20) |

**Seasonality**

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

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

**Comparison of Years Ended December 31, 2004 and 2005**

**Revenue**

Total revenue grew from $494.6 million in 2004, to $799.3 million in 2005, representing growth of 62%. During this same period, direct revenue increased from $213.2 million to $324.9 million (52% growth) and fulfillment partner revenue grew from $281.4 million to $474.4 million (69% growth). The significant increase in total revenue was due primarily to the increase in the number of orders (including both direct and fulfillment partner orders), which grew from 5.8 million in 2004 to 8.4 million in 2005 as a result of increased marketing efforts. Additionally, fulfillment partner revenue grew as a result of an increase in the number of fulfillment partners, which grew from 380 in 2004 to 460 in 2005. The increase in total revenue is also a reflection of our ability to acquire new customers from our marketing efforts, as evidenced by the addition of 3.8 million new customers during the year ended December 31, 2005 compared to 2.5 million new customers in the same period of 2004, an increase of 52%.

Gross bookings totaled $535.7 million and $868.0 million for the years ended December 31, 2004 and 2005, respectively, representing an increase of 62%. Gross bookings differ from GAAP revenue in that gross bookings represent the gross sales price of goods sold by the Company before returns, sales discounts and before payments to fulfillment partners prior to July 1, 2003.

**Gross Margins**

Total Gross Margins Cost of goods sold increased $254.0 million or 59% in absolute dollars, from $428.4 million during the year ended December 31, 2004 to $682.4 million during the year ended December 31, 2005. In comparing the years 2004 and 2005, total revenue increased 62% (from $494.6 million to $799.3 million) while gross profit dollars increased 77% (from $66.2 million to $116.9 million) during the same periods. As a percent of total revenue, cost of goods sold decreased from 87% to 85% for those respective periods resulting in improved gross margins of 13.4% and 14.6% for the years ended December 31, 2004 and 2005, respectively.

Direct Gross Margins Gross profits for our direct business increased 50% from $28.2 million for the year ended December 31, 2004 to $42.5 million recorded during the same period in 2005. Direct revenue increased 52% from $213.2 million during the year ended December 31, 2004 to $324.9 million during the year ended December 31, 2005. Gross profits as a percentage of direct revenue were 13.2% and 13.1% for the years ended December 31, 2004 and 2005, respectively.

In 2005, we were able to maintain the efficiencies we had gained in gross margins by the end of 2004. Margins also benefited (and are expected to benefit in the future) from the higher gross margins of the auctions business. Overall, the improvements in gross margins over the past two years are a result of efficiencies gained in several areas. In particular, we believe our buying has become more efficient as we continue to grow, allowing us to make larger inventory purchases and obtain more favorable pricing. Our total cost per package shipped (including outbound freight) has decreased due to better process management, lower packaging costs, and increased sales volumes. Additionally, we have made improvements to the cost of processing returns, customer service costs and credit card fees. Management believes that additional improvements can be made in gross margins, particularly in the customer service, order fulfillment and returns areas of the business.

Fulfillment Partner Gross Margins Our fulfillment partner business generated gross profits of $38.0 million and $74.4 million for the years ended December 31, 2004 and 2005, respectively, an increase of 96%. Gross profits as a percentage of fulfillment partner revenue increased from 13.5% for the year of 2004 to 15.7% for 2005.

The increase in gross profit dollars for our fulfillment partner operations was due to the general growth of the consumer business during the year, and an increase in the number of fulfillment partner products offered on our Websites. The increase in gross margins is largely due to improvements in product costs and credit card fees, as well as a decrease in BMMG gross bookings as a percentage of fulfillment partner revenue, from 22% in 2004 to 17% in 2005. Gross margins for BMMG products have historically been much lower than those of other product categories; however, we have made improvements in BMMG margins in 2005, which, in turn, increased the gross profit margin for the overall fulfillment partner operations.

**Fulfillment**

Fulfillment costs during the years ended December 31, 2004 and 2005 were $34.3 million and $59.9 million, respectively, or 7% of total revenue for those respective periods. Fulfillment costs include warehousing costs (excluding packaging costs), customer service costs and credit card fees. Fulfillment costs as a percentage of sales may vary due to several factors, such as such as significant changes in the number of units received and fulfilled, the extent we utilize third party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees.

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | | 2004 | | | 2005 | |
| Total revenue | $ | 494,635 | 100% | $ | 799,316 | 100% |
| Cost of goods sold | | | | | | |
| Product costs and other cost of goods sold | | 394,154 | 80% | | 622,509 | 78% |
| Fulfillment costs | | 34,278 | 7% | | 59,931 | 7% |
| Total cost of goods sold | | 428,432 | 87% | | 682,440 | 85% |
| Gross profit | $ | 66,203 | 13% | $ | 116,876 | 15% |

**Operating expenses**

*Sales and marketing.* Sales and marketing expenses totaled $40.6 million and $77.2 million for the years ended December 31, 2004 and 2005, respectively, representing an increase of 90%. For the year ended December 31, 2004 and 2005, sales and marketing expenses equaled 8% and 10%, respectively, of total revenue.

We direct customers to our websites primarily through a number of targeted online marketing channels, such as sponsored search, portal advertising, e-mail campaigns, and other initiatives. We also utilize channels such as nation-wide television, print and radio advertising campaigns. Our marketing expense is variable and is measured as a percentage of overall sales.

Overall online marketing expenditures has increased in absolute terms during the year ended December 31, 2005 compared to prior years as a result of increased online marketing rates during 2004 and 2005, and an increase in our ongoing online marketing efforts, particularly with the large portals (MSN, Yahoo & AOL), and keyword search (Google). In addition, we continued our television, print and radio campaigns throughout 2005. Our marketing costs have also increased as a percentage of sales due to marketing efforts in our auctions business. Since we record revenues in this business on a net basis, it typically has higher marketing expenses as a percent of total revenue.

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

Sales and marketing expenses have been reclassed to include stock-based compensation related to the adoption of SFAS 123(R) in 2005 of $26,000 and $4,000 during the years ended December 31, 2004 and 2005, respectively.

*Technology expenses.* Technology expenses increased 228%, from $8.5 million in the year ended December 31, 2004 to $27.9 million in same period ended December 31, 2005, representing 2% and 3% of total revenue for those respective periods..

We incurred a stair-step increase in technology costs during 2005 in an effort to prepare us for growth we anticipate over the next few years. The increase in expenditures was attributable to the increase in hardware, software and personnel costs, and depreciation associated with the development of the new infrastructure, including the ERP implementation, expansion of corporate systems and a database site license. The increase in technology expenses also included the costs associated with the strategic projects, including the development of an enterprise data warehouse and customer analytics system, completion of our auctions tab, reconstruction of our travel website, and development of our search engine and keyword management application.

Technology expenses have been reclassed to include stock-based compensation related to the adoption of SFAS 123(R) in 2005 of $60,000 and $11,000 during the years ended December 31, 2004 and 2005, respectively.

*General and administrative expenses.* General and administrative expenses increased 50% from $22.0 million during year ended December 31, 2004 to $33.0 million during the year ended December 31, 2005, representing 4% of total revenue for each of the respective periods.

The increase in general and administrative expenses in the year ended December 31, 2005 compared to the year ended December 31, 2004 related to the increases in primarily in payroll-related expenses, professional fees, merchandising, legal and finance costs. Also in the third quarter of 2005, we relocated our corporate offices to larger facilities to allow for future growth. As a result we now incur an additional rent expense of approximately $1.0 million quarterly.

*General and administrative* expenses have been reclassed to include stock-based compensation related to the adoption of SFAS 123(R) in 2005 of $238,000 and $51,000 during the years ended December 31, 2004 and 2005, respectively.

**Non-operating income (expense)**

*Interest income, interest expense and other income (expense).*

The primary component of our net interest income (expense) relates to the interest derived from the investment of our excess cash in marketable securities offset by interest expense related to the convertible debt, letters of credit, capital leases, and other related fees. Additionally, we incurred a large expense during the year related to the valuation of the conditional coupon of our foreign bonds. Interest income decreased from $1.2 million in the year ended December 31, 2004 to $270,000 negative interest income in the year ended December 31, 2005 due to the decreased valuation of our foreign bonds. During the first quarter of 2005, we purchased $49.9 million of Foreign Corporate Securities ( Foreign Notes ) which were scheduled to fully mature for $50.0 million in cash in November 2006. The Foreign Notes did not have a stated interest rate, but were structured to return the entire principal amount and a conditional coupon if held to maturity. The conditional coupon would provide a rate of return dependent on the performance of a basket of eight Asian currencies against the U.S. dollar. At December 31, 2005, the Foreign Notes had a fair value of $48.5 million.

Under SFAS No. 133, the Foreign Notes were considered to be derivative financial instruments and were marked to market quarterly. Any unrealized gain or loss related to the changes in value of the conditional coupon was recorded in the income statement as a component of interest income or expense. Any unrealized gain or loss related to the changes in the value of the Foreign Notes was recorded as a component of other comprehensive income (loss). For the year ended December 31, 2005, the combined overall fair value of the Foreign Notes decreased $1.5 million. The decrease was attributable to changes in the fair value of the conditional coupon resulting in a loss of $2.6 million, which was recorded in net income, and changes in fair value of the bond instrument resulting in a gain of $1.1 million, which was recorded as a component of other comprehensive income (loss) in the Balance Sheet. See Item 15 of Part IV, Financial Statements Note 6 Marketable Securities .

Interest expense is comprised largely of interest expense related to our convertible notes, capital leases and our line of credit. Interest expense increased from $775,000 during the year ended December 31, 2004 to $5.6 million during the year ended December 31, 2005, primarily as a result of the interest expense related to our convertible senior notes issued in November 2004.

We recorded other expense, net of $49,000 and other income, net of $4.7 million for the years ended December 31, 2004 and 2005, respectively. The gain realized during the year ended December 31, 2005 resulted from the retirement of $43.0 million of the 3.75% Convertible Senior Notes which occurred during the second and fourth quarters of 2005, resulting in a combined net gain of $6.2 million. See Item 15 of Part IV, Financial Statements Note 13 3.75% Convertible Senior Notes .

**Discontinued operations**

The results of operations for fiscal 2005 for the OTravel subsidiary have been reclassified to loss from discontinued operations. The loss from operations for the OTravel subsidiary was $2.6 million for the year ended December 31, 2005.

**Income taxes**

*Income taxes.* For the years ended December 31, 2004 and 2005, we incurred net operating losses, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2004 and 2005, we had net operating loss carryforwards of approximately $50.5 million and $58.0 million, respectively, which may be used to offset future taxable income. An additional $14.4 million of net operating losses are limited under Internal Revenue Code Section 382 to $799,000 a year. These net operating loss carryforwards will begin to expire in 2019.

**Quarterly Results of Operations**

The following tables set forth our unaudited quarterly results of operations data for the eight most recent quarters for the period ended December 31, 2006, as well as such data expressed as a percentage of our total revenue for the periods presented. The information in the table below should be read in conjunction with the Consolidated Financial Statements and the Notes thereto included elsewhere in this Form 10-K/A. We have prepared this information on the same basis as the Consolidated Financial Statements and the information includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair statement of our financial position and operating results for the quarters presented. Our quarterly operating results have varied substantially in the past and may vary substantially in the future. You should not draw any conclusions about our future results from the results of operations for any particular quarter.

| | Three Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Mar. 31, 2005 | June 30, 2005 | Sept. 30, 2005 | Dec. 31, 2005 | Mar. 31, 2006 | June 30, 2006 | Sept. 30, 2006 | Dec. 31, 2006 |
| | (in thousands, except per share data) | | | | | | | |
| **Consolidated Statement of Operations Data:** | | | | | | | | |
| Revenue | | | | | | | | |
| Direct revenue | $ 67,884 | $ 60,064 | $ 68,449 | $ 128,478 | $ 79,710 | $ 68,770 | $ 56,564 | $ 98,158 |
| Fulfillment partner revenue | 97,997 | 90,574 | 99,330 | 186,540 | 98,334 | 90,422 | 100,321 | 195,871 |
| Total revenue | 165,881 | 150,638 | 167,779 | 315,018 | 178,044 | 159,192 | 156,885 | 294,029 |
| Cost of goods sold | | | | | | | | |
| Direct | 58,262 | 51,567 | 59,169 | 113,385 | 70,703 | 61,473 | 51,037 | 101,730 |
| Fulfillment partner | 82,857 | 76,375 | 83,317 | 157,508 | 83,587 | 75,411 | 84,483 | 164,926 |
| Total cost of goods sold | 141,119 | 127,942 | 142,486 | 270,893 | 154,290 | 136,884 | 135,520 | 266,656 |
| Gross profit | 24,762 | 22,696 | 25,293 | 44,125 | 23,754 | 22,308 | 21,365 | 27,373 |
| Operating expenses: | | | | | | | | |
| Sales and marketing | 16,826 | 14,499 | 17,039 | 28,791 | 12,659 | 11,911 | 17,282 | 29,045 |
| Technology | 4,099 | 6,103 | 7,960 | 9,702 | 13,424 | 14,897 | 16,157 | 20,680 |
| General and administrative | 7,346 | 7,566 | 8,397 | 9,771 | 11,850 | 11,050 | 11,078 | 12,859 |
| Restructuring | | | | | | | | 5,674 |
| Total operating expenses | 28,271 | 28,168 | 33,396 | 48,264 | 37,933 | 37,858 | 44,517 | 68,258 |
| Operating loss | (3,509) | (5,472) | (8,103) | (4,139) | (14,179) | (15,550) | (23,152) | (40,885) |
| Interest income, net | 644 | 896 | (1,690) | (120) | 315 | 2,215 | 459 | 577 |
| Interest expense | (1,445) | (1,517) | (1,264) | (1,356) | (1,267) | (1,275) | (1,096) | (1,127) |
| Other income (expense), net | | 4,170 | 11 | 547 | | (1) | (6) | 88 |
| Loss from continuing operations | (4,310) | (1,923) | (11,046) | (5,068) | (15,131) | (14,611) | (23,795) | (41,347) |
| Discontinued operations: | | | | | | | | |
| Loss from discontinued operations | | | (1,356) | (1,215) | (779) | (1,128) | (708) | (4,267) |
| Net loss | (4,310) | (1,923) | (12,402) | (6,283) | (15,910) | (15,739) | (24,503) | (45,614) |
| Deemed dividend related to redeemable common stock | (46) | (47) | (47) | (45) | (33) | (33) | (33) | |
| Net loss attributable to common shares | $ (4,356) | $ (1,970) | $ (12,449) | $ (6,328) | $ (15,943) | $ (15,772) | $ (24,536) | $ (45,614) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net loss per common share basic and diluted | | | | | | | | |
| Loss from continuing operations | $ (0.22) | $ (0.10) | $ (0.59) | $ (0.27) | $ (0.78) | $ (0.73) | $ (1.16) | $ (1.95) |
| Loss from discontinued operations | $ | $ | $ (0.07) | $ (0.06) | $ (0.04) | $ (0.05) | $ (0.03) | $ (0.20) |
| Net loss per share basic and diluted | $ (0.22) | $ (0.10) | $ (0.66) | $ (0.33) | $ (0.82) | $ (0.78) | $ (1.19) | $ (2.15) |
| Weighted average common shares outstanding basic and diluted | 19,862 | 19,709 | 18,844 | 19,311 | 19,385 | 20,159 | 20,600 | 21,163 |

| | Three Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Mar. 31, 2005** | **June 30, 2005** | **Sept. 30, 2005** | **Dec. 31, 2005** | **Mar. 31, 2006** | **June 30, 2006** | **Sept. 30, 2006** | **Dec. 31, 2006** |
| **Additional Operating Data(1):** | | | | | | | | |
| Gross bookings (in thousands)(2) | $ 184,215 | $ 163,775 | $ 179,480 | $ 340,489 | $ 200,900 | $ 172,091 | $ 170,590 | $ 319,621 |
| Number of orders(3) | 1,915,000 | 1,588,000 | 1,768,000 | 3,176,000 | 1,856,000 | 1,568,000 | 1,529,000 | 3,061,000 |
| Number of new B2C customers(4) | 796,000 | 611,000 | 703,000 | 1,370,000 | 638,000 | 520,000 | 540,000 | 1,157,000 |
| Average customer acquisition cost(5) | $ 19.50 | $ 22.10 | $ 22.92 | $ 20.51 | $ 19.49 | $ 22.98 | $ 31.22 | $ 25.56 |

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(1) The additional operating data sets forth certain operating data relating to our business for the eight most recent quarters for the period ended December 31, 2006. While we believe that the information in the table above facilitates an understanding of our business and results of operations for the periods presented, such information is not in accordance with generally accepted accounting principles and should be read in conjunction with the quarterly results of operations data set forth above.

(2) Gross bookings excludes bookings related to the auctions and travel businesses (shopping business only). We believe that gross bookings is a metric widely used in our industry and by making this metric available to investors, we believe investors are able to compare our performance against others in our industry. We believe that investors may use the average customer acquisition cost metric to determine how efficiently we are able to achieve growth, if any. Again, we believe this metric is widely used in our industry, and providing these values to investors enables them to make more meaningful comparisons.

(3) Number of orders represents the number of individual orders for merchandise through our Websites excluding B2B orders.

(4) Number of new B2C customers represents the number of valid new customer accounts. To establish a valid customer account, a person must provide us with the following information and purchase merchandise on our B2C Website: a unique e-mail address; a unique password; and a verified credit card account number.

(5) Average customer acquisition cost represents total shopping sales and marketing expense divided by the number of new shopping customers for the period presented (excluding both new customers and marketing costs for the auctions business).

| Three Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Mar. 31, 2005** | **June 30, 2005** | **Sept. 30, 2005** | **Dec. 31, 2005** | **Mar. 31, 2006** | **June 30, 2006** | **Sept. 30, 2006** | **Dec. 31, 2006** |
| (as a percentage of total revenue) | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Revenue | | | | | | | | |
| Direct revenue | 40.9% | 39.9% | 40.8% | 40.8% | 44.8% | 43.2% | 36.1% | 33.4% |
| Fulfillment partner revenue | 59.1 | 60.1 | 59.2 | 59.2 | 55.2 | 56.8 | 63.9 | 66.6 |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of goods sold | | | | | | | | |
| Direct | 35.1 | 34.2 | 35.3 | 36.0 | 39.7 | 38.6 | 32.5 | 34.6 |
| Fulfillment partner | 49.9 | 50.7 | 49.6 | 50.0 | 47.0 | 47.4 | 53.9 | 56.1 |
| Total cost of goods sold | 85.0 | 84.9 | 84.9 | 86.0 | 86.7 | 86.0 | 86.4 | 90.7 |
| Gross profit | 15.0 | 15.1 | 15.1 | 14.0 | 13.3 | 14.0 | 13.6 | 9.3 |
| Operating expenses: | | | | | | | | |
| Sales and marketing | 10.1 | 9.6 | 10.2 | 9.1 | 7.1 | 7.5 | 11.0 | 9.9 |
| Technology | 2.5 | 4.1 | 4.7 | 3.1 | 7.5 | 9.4 | 10.3 | 7.0 |
| General and administrative | 4.4 | 5.0 | 5.0 | 3.1 | 6.7 | 6.9 | 7.1 | 4.4 |
| Restructuring | | | | | | | | 1.9 |
| Total operating expenses | 17.0 | 18.7 | 19.9 | 15.3 | 21.3 | 23.8 | 28.4 | 23.2 |
| Operating loss | (2.0) | (3.6) | (4.8) | (1.3) | (8.0) | (9.8) | (14.8) | (13.9) |
| Interest income | 0.4 | 0.6 | (1.0) | (0.0) | 0.2 | 1.4 | 0.3 | 0.2 |
| Interest expense | (0.9) | (1.0) | (0.8) | (0.5) | (0.7) | (0.8) | (0.7) | (0.4) |
| Other income (expense), net | | 2.8 | 0.0 | 0.2 | | (0.0) | (0.0) | 0.0 |
| Loss from continuing operations | (2.5)% | (1.2)% | (6.6)% | (1.6)% | (8.5)% | (9.2)% | (15.2)% | (14.1)% |

Total operating expenses has gradually increased as a percentage of total revenue each quarter since the beginning of 2006 primarily as a result of increases in marketing costs and our investment in an improved technology infrastructure.

Due to the foregoing factors, in one or more future quarters our operating results may fall below the expectations of securities analysts and investors. In such an event, the trading price of our common stock would likely be materially adversely affected.

**Off-Balance Sheet Arrangements**

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

**Liquidity and Capital Resources**

Prior to the second quarter of 2002, we financed our activities primarily through a series of private sales of equity securities, warrants to purchase our common stock and promissory notes. During the second quarter of 2002, we completed our initial public offering pursuant to which we received approximately $26.1 million in cash, net of underwriting discounts, commissions, and other related expenses. Additionally, we completed follow-on offerings in February 2003, May 2004 and November 2004, pursuant to which we received approximately $24.0 million, $37.9 million and $75.2 million, respectively, in cash, net of underwriting discounts, commissions, and other related expenses. In November 2004, we also received $116.2 million in proceeds from the issuance of our convertible senior notes in a transaction event exempt from registration under the Securities Act. During 2006, we received $64.4 million from two stock offerings in May and December. At December 31, 2006, our cash and cash equivalents balance was $127.0 million.

Our operating activities resulted in a net cash outflows of $6.1 million and $26.3 million for the years ended December 31, 2005 and 2006, respectively. The primary use of cash and cash equivalents during the year ended December 31, 2006 was to fund our operations, including net losses of $101.8 million (which includes $43.3 million of loss from discontinued operations and other net non-cash activity), as well as changes in accounts receivables, accounts payables and accrued liabilities of $2.1 million, $35.2 million and $6.2 million, respectively. This was offset by the cash provided from changes in inventory, prepaid inventory, prepaid expenses, and other long-term assets of $67.0 million , $7.4 million, $1.0 million and $496,000, respectively. For the year ended December 31, 2005, the primary use of cash and cash equivalents was to fund our operations, including net losses of $24.9 million, and changes in inventories ($46.7 million), prepaid expenses ($5.0 million), receivables ($4.3 million) and other long-term assets ($2.2 million). This was offset by the change in prepaid inventory ($2.7 million), accounts payable ($35.2 million) and accrued liabilities ($23.1 million).

We have payment terms with our fulfillment partners that extend beyond the amount of time necessary to collect proceeds from our customers. As a result, following our seasonally strong fourth quarter sales, at December 31 of each year, our cash, cash equivalents, marketable securities and accounts payable balances typically reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). However, our accounts payable balance normally declines during the first three months following year-end, which normally results in a decline in our cash, cash equivalents, and marketable securities balances in the first quarter each year.

Investing activities resulted in cash outflows of $37.7 million for the year ended December 31, 2005 and cash inflows of $33.4 million for the year ended December 31, 2006. The cash inflows of $33.4 million from investing activities in 2006 resulted from the sale of marketable securities of $56.8 million, including the sale of our foreign notes of $49.5 million in April, offset by expenditures for property and equipment of $23.4 million. Cash outflows from investing activities in 2005 resulted from investments in marketable securities of $185.5 million, expenditures for property and equipment of $44.6 million and the acquisition

64

of Ski West, Inc. for $25.1 million. This was offset by sales of marketable securities of $216.3 million. We plan to reduce capital expenditures to $10.0 million or less in 2007.

Financing activities resulted in cash outflows of $99.1 million for the year ended December 31, 2005 and cash inflows of $64.0 million for the year ended December 31, 2006. The cash inflows of $64.0 million in 2006 primarily are the result of $64.4 million received from the sale of our common stock and $2.5 million received from the exercise of employee stock options, offset by payments on capital lease obligations of $3.0 million. Cash outflows for financing activities in 2005 were primarily from capital lease payments of $7.1 million, payments of $35.7 million to retire our convertible senior notes, $24.1 million to purchase our common stock, and $47.5 million to purchase call options to purchase our common stock. These outflows in 2005 were offset by $7.9 million related to the settlement of call options for cash and $7.3 million from the exercise of stock options and warrants.

Certain prior-year amounts have been reclassified to conform to the current year s financial statement presentation. In addition, we have revised our consolidated statements of cash flows for the year ended December 31, 2005 to present the operating and investing portion of the cash flows attributable to discontinued operations on a separately identifiable basis. We had previously recorded these amounts on a combined basis.

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

*Contractual Obligations and Commitments.* The following table summarizes our contractual obligations as of December 31, 2006 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| **Contractual Obligations** | **Total** | **Less than 1 Year** | **1-3 Years** | **4-5 Years** | **After 5 years** |
| | | | (in thousands) | | |
| Long-term debt arrangements | $ 77,000 | $ | $ | $ 77,000 | $ |
| Interest on convertible senior notes | 14,438 | 2,888 | 5,775 | 5,775 | |
| Capital lease obligations | 10,025 | 5,997 | 4,028 | | |
| Operating leases | 48,666 | 8,718 | 12,841 | 10,867 | 16,240 |