

OVERSTOCK.COM, INC  
Form 10-Q  
November 03, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

Delaware

87-0634302

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

799 West Coliseum Way, Midvale, Utah

84047

(Address of principal executive offices)

(Zip Code)

(801) 947-3100

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

There were 25,383,283 shares of the Registrant's common stock, par value \$0.0001, outstanding on October 31, 2016.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.

Consolidated Balance Sheets (Unaudited)

(in thousands)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 124,471	\$ 170,262
Restricted cash	430	430
Accounts receivable, net	21,045	16,128
Inventories, net	15,717	20,042
Prepaid inventories, net	1,537	1,311
Deferred tax assets, net	14,740	26,305
Prepays and other current assets	17,475	13,890
Total current assets	195,415	248,368
Fixed assets, net	136,594	93,696
Precious metals	9,722	9,722
Deferred tax assets, net	43,486	37,891
Intangible assets, net	11,688	14,656
Goodwill	14,698	15,387
Other long-term assets, net	12,673	8,669
Total assets	\$ 424,276	\$ 428,389
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 84,912	\$ 122,705
Accrued liabilities	77,957	83,387
Deferred revenue	41,257	50,944
Finance obligations, current	2,241	1,059
Other current liabilities, net	1,577	581
Total current liabilities	207,944	258,676
Long-term debt, net	39,502	8,843
Finance obligations, non-current	8,074	4,535
Other long-term liabilities	9,164	6,974
Total liabilities	264,684	279,028
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value:		
Authorized shares - 5,000		
Issued and outstanding shares - none	—	—
Common stock, \$0.0001 par value		
Authorized shares - 100,000		
Issued shares - 27,846 and 27,634		
Outstanding shares - 25,383 and 25,234	3	3
Additional paid-in capital	374,152	370,047
Accumulated deficit	(156,993	) (166,420 )

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Accumulated other comprehensive loss	(3,054	) (1,430	)
Treasury stock:			
Shares at cost - 2,463 and 2,400	(52,484	) (51,747	)
Equity attributable to stockholders of Overstock.com, Inc.	161,624	150,453	
Equity attributable to noncontrolling interests	(2,032	) (1,092	)
Total equity	159,592	149,361	
Total liabilities and stockholders' equity	\$ 424,276	\$ 428,389	

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.  
Consolidated Statements of Operations (Unaudited)  
(in thousands, except per share data)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Revenue, net				
Direct	\$24,620	\$33,621	\$75,901	\$104,184
Partner and other	416,944	357,590	1,197,880	1,073,384
Total net revenue	441,564	391,211	1,273,781	1,177,568
Cost of goods sold				
Direct(1)	23,955	31,989	72,459	95,751
Partner and other	337,893	286,771	967,977	860,272
Total cost of goods sold	361,848	318,760	1,040,436	956,023
Gross profit	79,716	72,451	233,345	221,545
Operating expenses:				
Sales and marketing(1)	34,707	30,062	99,516	86,121
Technology(1)	26,739	25,084	78,249	72,230
General and administrative(1)	23,317	20,676	67,843	60,639
Litigation settlement	—	—	(19,520)	—
Total operating expenses	84,763	75,822	226,088	218,990
Operating income (loss)	(5,047)	(3,371)	7,257	2,555
Interest income	73	37	228	118
Interest expense	(212)	(62)	(219)	(74)
Other income, net	1,251	764	9,399	2,532
Income (loss) before income taxes	(3,935)	(2,632)	16,665	5,131
Provision (benefit) for income taxes	(543)	(15)	8,178	3,774
Consolidated net income (loss)	\$(3,392)	\$(2,617)	\$8,487	\$1,357
Less: Net loss attributable to noncontrolling interests	(294)	(546)	(940)	(979)
Net income (loss) attributable to stockholders of Overstock.com, Inc.	\$(3,098)	\$(2,071)	\$9,427	\$2,336
Net income (loss) per common share—basic:				
Net income (loss) attributable to common shares—basic	\$(0.12)	\$(0.08)	\$0.37	\$0.10
Weighted average common shares outstanding—basic	25,356	24,681	25,326	24,402
Net income (loss) per common share—diluted:				
Net income (loss) attributable to common shares—diluted	\$(0.12)	\$(0.08)	\$0.37	\$0.10
Weighted average common shares outstanding—diluted	25,356	24,681	25,388	24,513

(1) Includes stock-based compensation as follows (Note 7):

Cost of goods sold — direct	\$69	\$52	\$200	\$129
Sales and marketing	102	50	234	140
Technology	210	165	615	491
General and administrative	1,009	572	3,056	1,817
Total	\$1,390	\$839	\$4,105	\$2,577

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Consolidated net income (loss)	\$(3,392)	\$(2,617)	\$8,487	\$1,357
Other comprehensive loss:				
Unrealized loss on cash flow hedges, net of benefit (expense) for taxes of \$(346), \$581, \$718 and \$662	(64 )	(907 )	(1,624 )	(1,022 )
Other comprehensive loss	(64 )	(907 )	(1,624 )	(1,022 )
Comprehensive income (loss)	\$(3,456)	\$(3,524)	\$6,863	\$335
Less: Comprehensive loss attributable to noncontrolling interests	(294 )	(546 )	(940 )	(979 )
Comprehensive income (loss) attributable to stockholders of Overstock.com, Inc.	\$(3,162)	\$(2,978)	\$7,803	\$1,314

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)  
(in thousands)Nine  
months  
ended  
September  
30, 2016

Equity attributable to stockholders of Overstock.com, Inc.

Number of common shares issued

Balance at beginning of period

27,634

Common stock issued upon vesting of restricted stock

212

Balance at end of period

27,846

Number of treasury stock shares

Balance at beginning of period

2,400

Purchases of treasury stock

63

Balance at end of period

2,463

Total number of outstanding shares

25,383

Common stock

\$3

Additional paid-in capital

Balance at beginning of period

\$370,047

Stock-based compensation to employees and directors

4,105

Balance at end of period

\$374,152

Accumulated deficit

Balance at beginning of period

\$(166,420)

Net income attributable to stockholders of Overstock.com, Inc.

9,427

Balance at end of period

\$(156,993)

Accumulated other comprehensive loss

Balance at beginning of period

\$(1,430 )

Net other comprehensive loss

(1,624 )

Balance at end of period

\$(3,054 )

Treasury stock

Balance at beginning of period

\$(51,747 )

Purchases of treasury stock

(737 )

Balance at end of period

(52,484 )

Total equity attributable to stockholders of Overstock.com, Inc. \$161,624

Equity attributable to noncontrolling interests

Balance at beginning of period

\$(1,092 )

Net loss attributable to noncontrolling interests

(940 )

Total equity attributable to noncontrolling interests

\$(2,032 )

Total equity

\$159,592



See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Nine months ended September 30,		Twelve months ended September 30,	
	2016	2015	2016	2015
Cash flows from operating activities:				
Consolidated net income	\$8,487	\$1,357	\$8,350	\$2,662
Adjustments to reconcile net income to net cash (used in) provided by operating activities:				
Depreciation of fixed assets	19,710	17,384	26,729	22,522
Amortization of intangible assets	3,193	443	3,444	563
Stock-based compensation to employees and directors	4,105	2,577	5,054	3,663
Deferred income taxes, net	6,688	3,470	4,701	4,302
Amortization of debt issuance costs	—	21	—	21
Loss on investment in precious metals	—	662	521	1,179
Loss on investment in cryptocurrency	—	147	5	147
Impairment of cost method investment	2,850	—	2,850	—
Ineffective portion of loss on cash flow hedge	—	124	—	124
Termination costs of cryptobond financing	—	—	850	—
Other	207	9	207	(38 )
Changes in operating assets and liabilities, net of acquisitions:				
Restricted cash	—	—	—	1,000
Accounts receivable, net	(2,909 )	2,662	(2,108 )	(1,360 )
Inventories, net	4,325	3,002	7,489	2,077
Prepaid inventories, net	(226 )	1,936	(259 )	445
Prepays and other current assets	(3,456 )	(3,782 )	(1,012 )	(1,753 )
Other long-term assets, net	(356 )	380	(670 )	413
Accounts payable	(40,247 )	(47,313 )	17,548	1,851
Accrued liabilities	(8,678 )	(17,751 )	4,920	1,020
Deferred revenue	(9,687 )	(3,298 )	(3,896 )	4,502
Other long-term liabilities	555	1,570	754	1,590
Net cash (used in) provided by operating activities	(15,439 )	(36,400 )	75,477	44,930
Cash flows from investing activities:				
Investment in precious metals	—	—	—	(2,496 )
Investment in cryptocurrency	—	—	—	96
Equity method investment	—	(152 )	—	(402 )
Disbursement of note receivable	(3,050 )	(5,000 )	(3,050 )	(5,000 )
Cost method investments	(4,000 )	(7,000 )	(4,000 )	(7,000 )
Acquisitions of businesses, net of cash acquired	1,220	(10,573 )	1,192	(10,573 )
Expenditures for fixed assets, including internal-use software and website development	(59,382 )	(43,381 )	(75,514 )	(52,183 )
Other	46	(133 )	14	(175 )
Net cash used in investing activities	(65,166 )	(66,239 )	(81,358 )	(77,733 )
Cash flows from financing activities:				
Payments on capital lease obligations	—	(362 )	—	(362 )
Paydown on direct financing arrangement	(54 )	(229 )	(134 )	(302 )
Payments on finance obligations	(1,354 )	—	(1,458 )	—

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Payments on interest swap	(563	) —	(620	) —
Proceeds from finance obligations	6,075	—	11,773	—
Proceeds from short-term debt	—	5,500	—	5,500
Payments on short-term debt	—	—	(750	) —
Proceeds from long-term debt	31,447	—	40,935	—
Change in restricted cash	—	75	75	75
Proceeds from exercise of stock options	—	270	—	439
Purchase of treasury stock	(737	) (2,367	) (737	) (2,367
Payment of debt issuance costs	—	(621	) —	(1,652
Net cash provided by financing activities	34,814	2,266	49,084	1,331
Net (decrease) increase in cash and cash equivalents	(45,791	) (100,373)	43,203	(31,472
Cash and cash equivalents, beginning of period	170,262	181,641	81,268	112,740
Cash and cash equivalents, end of period	\$124,471	\$81,268	\$124,471	\$81,268

Continued on the following page

Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(Continued)

(in thousands)

	Nine months ended		Twelve months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Supplemental disclosures of cash flow information:				
Cash paid during the period:				
Interest paid (net of amounts capitalized)	\$675	\$35	\$864	\$45
Taxes paid	1,206	272	1,207	312
Non-cash investing and financing activities:				
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	\$9,574	\$1,414	\$9,574	\$1,414
Equipment acquired under capital lease obligations	—	362	—	362
Capitalized interest cost	117	117	157	143
Acquisition of businesses through stock issuance	—	18,149	—	18,149
Change in value of cash flow hedge	1,780	1,684	1,361	2,692
Note receivable converted to cost method investment	2,850	—	2,850	—

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

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

We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2015. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of results for the interim periods presented. Preparing financial statements requires us to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on our best knowledge of current events and actions that we may undertake in the future, actual results may be different from the estimates. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

For purposes of comparability, we reclassified certain immaterial amounts in the prior periods presented to conform with the current year presentation.

2. ACCOUNTING POLICIES

Principles of consolidation

The accompanying consolidated financial statements include our accounts and the accounts of our wholly-owned and majority-owned subsidiaries. All intercompany account balances and transactions have been eliminated in consolidation.

Use of estimates

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

Cash equivalents

We classify all highly liquid instruments, including instruments with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were \$45.1 million and \$28.1 million at September 30, 2016 and December 31, 2015, respectively.

Restricted cash

We consider cash that is legally restricted and cash that is held as a compensating balance for letter of credit arrangements as restricted cash.

Fair value of financial instruments

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

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

Level 1—Quoted prices for identical instruments in active markets;

Level 2—Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Under GAAP, certain assets and liabilities are required to be recorded at fair value on a recurring basis. Our assets and liabilities that are adjusted to fair value on a recurring basis are investments in money market mutual funds, trading securities, derivative instruments, and deferred compensation liabilities.

The fair values of our investments in money market mutual funds, trading securities, and deferred compensation liabilities are determined using quoted market prices from daily exchange traded markets on the closing price as of the balance sheet date and are classified as Level 1.

The fair values of our derivative instruments are determined using standard valuation models. The significant inputs used in these models are readily available in public markets, or can be derived from observable market transactions, and therefore have been classified as Level 2. Inputs used in these standard valuation models for derivative instruments include the applicable forward rates, interest rates and discount rates. Included in the fair value of derivative instruments is an adjustment for nonperformance risk. The adjustment for nonperformance risk did not have a significant impact on the estimated fair value of our derivative instruments. For additional disclosures related to our derivative instruments, see Derivative financial instruments below.

The following tables summarize our assets and liabilities measured at fair value on a recurring basis using the following levels of inputs as of September 30, 2016 and December 31, 2015 as indicated (in thousands):

	Fair Value Measurements at September 30, 2016:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	\$ 45,149	\$ 45,149	\$ —	\$ —
Trading securities held in a “rabbi trust” (1)	55	55	—	—
Total assets	\$ 45,204	\$ 45,204	\$ —	\$ —
Liabilities:				
Derivatives (2)	\$ 4,256	\$ —	\$ 4,256	\$ —
Deferred compensation accrual “rabbi trust” (3)	57	57	—	—
Total liabilities	\$ 4,313	\$ 57	\$ 4,256	\$ —
	Fair Value Measurements at December 31, 2015:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	\$ 28,102	\$ 28,102	\$ —	\$ —
Trading securities held in a “rabbi trust” (1)	68	68	—	—
Total assets	\$ 28,170	\$ 28,170	\$ —	\$ —
Liabilities:				
Derivatives (2)	\$ 2,356	\$ —	\$ 2,356	\$ —
Deferred compensation accrual “rabbi trust” (3)	70	70	—	—

Total liabilities	\$ 2,426	\$ 70	\$ 2,356	\$ —
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(1) — Trading securities held in a rabbi trust are included in Prepaids and other current assets and Other long-term assets, net in the consolidated balance sheets.

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- (2) — Derivative financial instruments are included in Other current liabilities, net and Other long-term liabilities in the consolidated balance sheets.
- (3) — Non qualified deferred compensation in a rabbi trust is included in Accrued liabilities and Other long-term liabilities in the consolidated balance sheets.

Our other financial instruments, including cash, restricted cash, accounts receivable, accounts payable, accrued liabilities, finance obligations and debt are carried at cost, which approximates their fair value.

### Accounts receivable

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

### Allowance for doubtful accounts

From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We perform credit evaluations of our business customers' financial condition and payment history and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was \$2.0 million and \$465,000 at September 30, 2016 and December 31, 2015, respectively. The increase in our allowance for doubtful accounts receivable was primarily due to an increase in our allowance for a marketplace in which we hold a minority investment (and in which we recognized an impairment charge during the three months ended September 30, 2016).

### Concentration of credit risk

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At September 30, 2016 and December 31, 2015, two banks held the majority of our cash and cash equivalents. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of cash equivalents and receivables. We invest our cash primarily in money market securities which are uninsured.

### Valuation of inventories

Inventories, consisting of merchandise purchased for resale, are accounted for using a standard costing system which approximates the first-in-first-out ("FIFO") method of accounting, and are valued at the lower of cost or market. We write down our inventory for estimated obsolescence and to lower of cost or market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory allowance represents the new cost basis of such products. Reversal of the allowance is recognized only when the related inventory has been sold or scrapped.

### Prepaid inventories, net

Prepaid inventories, net represent inventories paid for in advance of receipt.

### Prepays and other current assets



Prepays and other current assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs.

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## Fixed assets

During Q3 2016, we substantially completed the construction of a new corporate headquarters and we placed the related fixed assets in service during the period. These assets include the building, land improvements, building machinery and equipment, and additional furniture and equipment. Our fixed assets, which also include technology infrastructure, internal-use software, website development and leasehold improvements, are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the related assets or the term of the related capital lease, whichever is shorter. During Q3 2016, we changed the estimated useful life of our furniture and equipment from 3-5 years to 5-7 years, due primarily to our acquisition of longer lived furniture and equipment for our new headquarters. This change in estimate will be applied prospectively. We do not expect this change in estimate to have a material impact on our financial statements. Substantially all of the furniture and equipment from our previous headquarters was fully depreciated. The estimated useful lives of our fixed assets are as follows:

	Life (years)
Building	40
Land improvements	20
Building machinery and equipment	15-20
Furniture and equipment	5-7
Computer hardware	3-4
Computer software	2-4

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

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Cost of goods sold - direct	\$77	\$73	\$235	\$206
Technology	6,952	5,875	18,755	16,331
Marketing	29	—	29	—
General and administrative	357	284	691	847
Total depreciation, including internal-use software and website development	\$7,415	\$6,232	\$19,710	\$17,384

Total accumulated depreciation of fixed assets was \$174.3 million and \$156.8 million at September 30, 2016 and December 31, 2015, respectively.

## Capitalized interest

We capitalize interest costs incurred on debt during the construction of major projects. Capitalized interest for the three and nine months ended September 30, 2016 and 2015 was immaterial.

## Internal-use software and website development

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

During the three months ended September 30, 2016 and 2015, we capitalized \$3.2 million and \$4.4 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was \$5.0 million and \$3.9 million, respectively, for those respective periods. During the nine months ended September 30, 2016 and 2015, we capitalized

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\$13.3 million and \$13.8 million, respectively, of such costs and had amortization of \$12.7 million and \$10.8 million for those respective periods.

### Cost method investments

At September 30, 2016, we held minority interests (less than 20%) in five privately held entities. The total aggregate amount of these investments was approximately \$13.9 million. For one of our investments we agreed to make a subsequent \$3.0 million investment, and a \$3.0 million loan, that are contingent on the investee reaching certain milestones. We do not know when, or if, the investee will reach such milestones. We did not acquire a controlling interest in this investee, nor would our interest become controlling if we were to make the subsequent investment. Based on the nature of our investment, we have a variable interest in this investee. However, because we do not have power to direct the investee's activities, and therefore we are not the investee's primary beneficiary, we do not consolidate the investee in our financial statements. In June 2016, in order to maintain our proportional interest, we made a \$200,000 convertible loan to an investee. The loan will convert to an equity interest no later than January 2018.

These investments are recognized as cost method investments included in Other long-term assets, net in our consolidated balance sheets. Earnings from the investments are recognized to the extent of dividends received, and we will recognize subsequent impairments to the investment if they are other than temporary. We review these investments individually for impairment by evaluating if events or circumstances have occurred that may have a significant adverse effect on their fair value. If such events or circumstances have occurred, we will estimate the fair value of the investment and determine if any decline in the fair value of the investment below its carrying value is other-than-temporary. In such cases, the estimated fair value of the investment is determined using unobservable inputs including assumptions by the investee's management. These inputs are classified as Level 3. See Fair value of financial instruments above.

At September 30, 2016, the carrying amount of our cost method investments was \$11.0 million. We recognized a \$2.9 million impairment loss during the three and nine months ended September 30, 2016, which consisted of the entire carrying amount of the related investment. The impairment loss was recorded in other income, net on the consolidated statements of operations. We recognized no impairment losses during the year ended 2015.

### Noncontrolling interests

During 2014, we formed tØ.com, Inc. (formerly Medici, Inc.) to develop blockchain and fintech technology as part of our Medici initiatives. tØ.com is a majority owned subsidiary of Overstock. During Q1 2016, tØ.com completed the acquisition of a financial technology firm and two registered broker dealers, each of which was under common control with the firm from which the financial technology assets were purchased. The former owners of that firm hold noncontrolling interests in tØ.com. These transactions are described further in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. The proceeds for the acquisitions were financed by tØ.com through a note payable to Overstock that bears interest at a rate that approximates the Federal Funds Rate. tØ.com is included in our consolidated financial statements. Intercompany transactions have been eliminated and the amounts of contributions and gains or losses that are attributable to the noncontrolling interests are disclosed in our consolidated financial statements.

### Leases

We account for lease agreements as either operating or capital leases depending on certain defined criteria. In certain of our lease agreements, we receive rent holidays and other incentives. We recognize lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays, that defer the commencement date of required

payments. Additionally, tenant improvement allowances are amortized as a reduction in rent expense over the term of the lease. Leasehold improvements are capitalized at cost and amortized over the lesser of their expected useful life or the life of the lease, without assuming renewal features, if any, are exercised.

#### Treasury stock

We account for treasury stock under the cost method and include treasury stock as a component of stockholders' equity.

#### Precious metals

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Our precious metals consisted of \$5.7 million in gold and \$4.0 million in silver at September 30, 2016 and December 31, 2015. We store our precious metals at an off-site secure facility. Because these assets consist of actual precious metals, rather than financial instruments, we account for them as an investment initially recorded at cost (including transaction fees) and then adjusted to the lower of cost or market based on an average unit cost. On an interim basis, we recognize decreases in the value of these assets caused by market declines. Subsequent increases in the value of these assets through market price recoveries during the same fiscal year are recognized in the later interim period, but may not exceed the total previously recognized decreases in value during the same year. Gains or losses resulting from changes in the value of our precious metal assets are recorded in Other income, net in our consolidated statements of operations. There were no recorded gains or losses on investments in precious metals for the three and nine months ended September 30, 2016. We recorded a \$610,000 and \$662,000 loss on investments in precious metals for the three and nine months ended September 30, 2015.

## Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired in business combinations. Goodwill is not amortized but is tested for impairment at least annually. When evaluating whether goodwill is impaired, we make a qualitative assessment to determine if it is more likely than not that its fair value is less than its carrying amount. If the qualitative assessment determines that it is more likely than not that its fair value is less than its carrying amount, we compare the fair value of the reporting unit to which the goodwill is assigned to its carrying amount. If the carrying amount exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss, if any, is calculated by comparing the implied fair value of the goodwill to its carrying amount. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to the other assets and liabilities within the reporting unit based on estimated fair value. The excess of the fair value of a reporting unit over the amount allocated to its other assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized when the carrying amount of goodwill exceeds its implied fair value.

In accordance with this guidance, we test for impairment of goodwill annually or when we deem that a triggering event has occurred. There were no impairments to goodwill recorded during the nine months ended September 30, 2016 or the year ended December 31, 2015.

During the nine months ended September 30, 2016, we recognized a \$689,000 adjustment in goodwill related to a business combination as described in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. The change in goodwill relates to a non-reportable segment, included in Other as described in Note 8—Business Segments.

## Intangible assets other than goodwill

We capitalize and amortize intangible assets other than goodwill over their estimated useful lives unless such lives are indefinite. Intangible assets other than goodwill acquired separately from third-parties are capitalized at cost while such assets acquired as part of a business combination are capitalized at their acquisition-date fair value. Intangible assets other than goodwill are amortized using the straight line method of amortization over their useful lives, with the exception of certain intangibles (such as acquired technology, customer relationships, and trade names) which are amortized using an accelerated method of amortization based on cash flows. These assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable as described below under Impairment of long-lived assets.

During the nine months ended September 30, 2016, we acquired \$224,000 of intangible assets other than goodwill related to a business combination as described in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. Aggregate amortization expense for acquired intangible assets other than goodwill was \$1.0 million and \$354,000 for the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016

and 2015, the aggregate amortization expense for intangible assets other than goodwill was \$3.2 million and \$443,000, respectively.

#### Impairment of long-lived assets

We review property and equipment and other long-lived assets, including intangible assets other than goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability is measured by comparison of the assets' carrying amount to future undiscounted net cash flows the asset group is expected to generate. Cash flow forecasts are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. If such asset group is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying

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amount of the assets exceeds their fair values. There were no impairments to long-lived assets recorded during the nine months ended September 30, 2016 or the year ended December 31, 2015.

### Cryptocurrency holdings

We hold cryptocurrency-denominated assets such as bitcoin and we include them in prepaids and other current assets in our consolidated balance sheets. Cryptocurrency-denominated assets were \$288,000 and \$226,000 at September 30, 2016 and December 31, 2015, respectively, and are recorded at the lower of cost or market based on an average unit cost. On an interim basis, we recognize decreases in the value of these assets caused by market declines. Subsequent increases in the value of these assets through market price recoveries during the same fiscal year are recognized in the later interim period, but may not exceed the total previously recognized decreases in value during the same year. Gains or losses resulting from changes in the value of our cryptocurrency assets are recorded in Other income, net in our consolidated statements of operations. There were no recorded gains or losses on cryptocurrency holdings during the nine months ended September 30, 2016. Losses on cryptocurrency holdings were \$147,000 during the nine months ended September 30, 2015.

### Other long-term assets, net

Other long-term assets consist primarily of cost and equity method investments (see Cost method investments above) and long-term prepaid expenses.

### Derivative financial instruments

In 2014, we entered into a loan agreement in connection with the construction of our new corporate headquarters. We began borrowing under the facility in October 2015. Because amounts borrowed on the loan will carry a variable LIBOR-based interest rate, we will be affected by changes in certain market conditions. These changes in market conditions may adversely impact our financial performance, and as such, we use derivatives as a risk management tool to mitigate the potential impact of these changes. We do not enter into derivatives for speculative or trading purposes. The primary market risk we manage through the use of derivative instruments is interest rate risk on the amounts we have borrowed under the loan agreement relating to our new headquarters. To manage that risk, we use interest rate swap agreements. An interest rate swap agreement is a contract between two parties to exchange cash flows based on underlying notional amounts and indices. Our interest rate swaps entitle us to pay amounts based on a fixed rate in exchange for receipt of amounts based on variable rates over the term of the related loan agreement. The notional amounts under our hedges were \$45.1 million and \$20.5 million at September 30, 2016 and December 31, 2015, respectively.

Our derivatives are carried at fair value in our consolidated balance sheets in Other current liabilities, net and Other long-term liabilities on a gross basis. The accounting for gains and losses that result from changes in the fair values of derivative instruments depends on whether the derivatives have been designated and qualify as hedging instruments under GAAP. Our derivatives have been designated and qualify as cash flow hedges. We formally designated and documented, at inception, the financial instruments as hedges of specific underlying exposures, the risk management objectives, and the strategy for undertaking the hedging transactions. In addition, we formally assess, both at the inception and at least quarterly thereafter, whether the financial instruments used in hedging transactions are effective at offsetting changes in the cash flows of the related underlying exposures. To the extent that the hedges are effective, the changes in fair values of our cash flow hedges are recorded in Accumulated other comprehensive income (loss) in the consolidated statements of changes in stockholders' equity. Any ineffective portion is immediately recognized into earnings. The variable-rate interest on the borrowing for our new corporate headquarters was capitalized during the construction period. The amounts in Accumulated other comprehensive income (loss) related to the cash flow hedge of the variability of the interest that was capitalized is reclassified into earnings over the depreciable life of the asset.



During the three and nine months ended September 30, 2015, the amount of gains or losses in accumulated other comprehensive income that has been reclassified into earnings was not material and the amounts at September 30, 2016 that we will reclassify into earnings within the next 12 months is not expected to be material.

We determine the fair values of our derivatives based on quoted market prices or using standard valuation models (see Fair value of financial instruments above). The notional amounts of the derivative financial instruments do not necessarily represent amounts exchanged by the parties and, therefore, are not a direct measure of our exposure to the financial risks described above. The amounts exchanged are calculated by reference to the notional amounts and by other terms of the derivatives, such as interest rates.

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The following table shows the effect of derivative financial instruments that were designated as accounting hedges for the period indicated (in thousands):

Cash flow hedges	Amount of gain (loss) recognized in OCI on derivative (effective portion) net of tax	Location of gain (loss) reclassified from OCI into operations (effective portion)	Amount of gain (loss) reclassified from Accumulated OCI into operations (effective portion)	Location of gain (loss) recognized in operations on derivative (ineffective portion)	Amount of gain (loss) recognized in operations on derivative (ineffective portion)
Three months ended September 30, 2016					
Interest rate swap	\$ (64 )	Interest expense	\$ 1	Other income (expense)	\$ —
Nine months ended September 30, 2016					
Interest rate swap	\$ (1,624 )	Interest expense	\$ 1	Other income (expense)	\$ —

The following table provides the outstanding notional balances and fair values of derivative financial instruments that were designated as accounting hedges outstanding positions for the dates indicated, and recorded gains/(losses) during the periods indicated (in thousands):

Cash flow hedges	Location in balance sheet	Expiration date	Outstanding notional	Fair value	Beginning gains (losses)	Gains (losses) recorded during period (1)	Ending gains (losses)
Three months ended September 30, 2016							
Interest rate swap	Current and Other long-term liabilities	2023	\$ 45,054	\$(4,256)	\$(4,683 )	\$427	\$(4,256)
Nine months ended September 30, 2016							
Interest rate swap	Current and Other long-term liabilities	2023	\$ 45,054	\$(4,256)	\$(2,397 )	\$(1,859 )	\$(4,256)

(1) — Gains (losses) recorded during the period are presented gross of the related tax impact.

## Revenue recognition

We derive our revenue primarily from direct revenue and partner revenue from merchandise sales. We also earn revenue from advertising on our website and from other pages. We have organized our operations into two principal reporting segments based on the primary source of revenue: direct revenue and partner revenue (see Note 8—Business Segments).

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

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

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

We evaluate the revenue recognition criteria above for our broker-dealer subsidiaries (see Note 9 - Broker Dealers) and we recognize securities transactions (and the related commission revenue) on a trade date and gross basis.

### Direct revenue

Direct revenue is derived from merchandise sales of our owned inventory to individual consumers and businesses. Direct revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels.

### Partner and other revenue

Partner and other revenue is derived primarily from merchandise sales of inventory owned by our partners which they generally ship directly to our consumers and businesses. Partner and other revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels.

### Club O loyalty program

We have a customer loyalty program called Club O Gold for which we sell annual memberships. For Club O Gold memberships, we record membership fees as deferred revenue and we recognize revenue ratably over the membership period. The Club O Gold loyalty program allows members to earn Club O Reward dollars for qualifying purchases made on our Website. We also have a co-branded credit card program (see Co-branded credit card program below for more information). Co-branded cardholders are also Club O Gold members and earn additional reward dollars for purchases made on our Website, and from other merchants.

Beginning in 2015, we enrolled a significant number of members in Club O Silver, a newly introduced Club O membership tier for customers who agree to receive promotional emails. Club O Silver members earned Club O Rewards on qualifying purchases that expire after 90 days from a qualifying purchase. We discontinued Club O Silver in October 2016. Since the program's introduction, the growth in Club O Silver caused increases in reward dollars earned and resulting breakage. The increases in reward breakage attributable to Club O Silver may continue as compared to prior periods for several months until all remaining Club O Silver rewards have expired.

Earned Club O Reward dollars may be redeemed on future purchases made through our Website. We recognize revenue for Club O Reward dollars when customers redeem their reward dollars as part of a purchase on our Website. We account for these transactions as multiple element arrangements and allocate revenue to the elements using their relative fair values. We include the value of reward dollars earned in deferred revenue and we record it as a reduction of revenue at the time the reward dollars are earned. Club O Gold membership reward dollars expire 90 days after the customer's Club O Gold membership expires. When Club O Reward dollars expire, we recognize reward dollar

breakage as Other income, net in our consolidated statements of operations.

In instances where customers receive free Club O Reward dollars not associated with any purchases, we account for these transactions as sales incentives such as coupons and record a reduction of revenue at the time the reward dollars are redeemed.

Co-branded credit card program

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We have a co-branded credit card agreement with a commercial bank for the issuance of credit cards bearing the Overstock.com brand, under which the bank pays us fees for new accounts and for customer usage of the cards. The agreement also provides for a customer loyalty program offering reward points that customers will accrue from card usage and can use to make purchases on our Website (see Club O loyalty program above for more information). New account fees are recognized as revenue on a straight-line basis over the estimated expected life of co-branded credit card customers. Credit card usage fees are recognized as revenues as actual credit card usage occurs.

We also have a private label credit card agreement with another commercial bank for the issuance of credit cards bearing our brand, but that is only available for use on our Website. In connection with the agreement, we received upfront fees that we recognize as revenue on a straight line basis over the term of the agreement, which runs through February 2022. When customers make regular revolving purchases using the card, we receive fees, which are recognized as revenue. When we offer promotional financing for purchases made with the card (for example, 12 months same as cash), we pay a discount fee to the commercial bank, which we recognize as a reduction of revenue. The commercial bank owns all of the accounts under the program and performs all account administration, underwriting and servicing. Fees and royalties from new accounts, credit card usage fees, and fees from both of these cards were less than 1% of total net revenues for all periods presented.

### Deferred revenue

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

We periodically enter into agreements with other parties to jointly market ancillary products or services on our website. As a result of those agreements, we sometimes receive payments in advance of performing our obligations under those agreements. Such payments received before we perform our obligations are initially recorded as deferred revenue and then recognized over our service period.

### Sales returns allowance

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

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

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

Revenue is recorded net of estimated returns. We record an allowance for returns based on current period revenues and historical returns experience. We analyze actual historical returns, current economic trends and changes in order

volume and acceptance of our products when evaluating the adequacy of the sales returns allowance in any accounting period.

The allowance for returns was \$12.8 million and \$17.9 million at September 30, 2016 and December 31, 2015 respectively.

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## Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was \$327,000 and \$240,000 at September 30, 2016 and December 31, 2015, respectively.

## Cost of goods sold

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

	Three months ended				Nine months ended			
	September 30,		September 30,		September 30,		September 30,	
	2016	2015	2016	2015	2016	2015	2016	2015
Total revenue, net	\$441,564	100 %	\$391,211	100 %	\$1,273,781	100 %	\$1,177,568	100 %
Cost of goods sold								
Product costs and other cost of goods sold	343,401	78 %	301,164	77 %	985,603	77 %	903,720	77 %
Fulfillment and related costs	18,447	4 %	17,596	4 %	54,833	4 %	52,303	4 %
Total cost of goods sold	361,848	82 %	318,760	81 %	1,040,436	82 %	956,023	81 %
Gross profit	\$79,716	18 %	\$72,451	19 %	\$233,345	18 %	\$221,545	19 %

## Advertising expense

We expense the costs of producing advertisements the first time the advertising takes place and expense the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to the Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled \$31.5 million and \$27.7 million during the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015, advertising expenses totaled \$90.6 million and \$79.5 million, respectively. Prepaid advertising (included in Prepaids and other current assets in the accompanying consolidated balance sheets) was \$1.9 million and \$1.2 million at September 30, 2016 and December 31, 2015, respectively.

## Stock-based compensation

We measure compensation expense for all outstanding unvested share-based awards at fair value on the date of grant and recognize compensation expense over the service period for awards expected to vest at the greater of a straight line basis or on an accelerated schedule when vesting of restricted stock awards exceeds a straight line basis. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts are recorded as an adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, and historical experience. Actual results may differ substantially from these estimates (see Note 7—Stock-Based Awards).

## Loss contingencies



In the normal course of business, we are involved in legal proceedings and other potential loss contingencies. We accrue a liability for such matters when it is probable that a loss has been incurred and the amount can be reasonably estimated. When only a range of probable loss can be estimated, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. We expense legal fees as incurred (see Note 5—Commitments and Contingencies).

Income taxes

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Our income tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, for relevant interim periods. We update our estimate of the annual effective tax rate each quarter and make cumulative adjustments if our estimated annual effective tax rate changes.

Our quarterly tax provision and our quarterly estimate of our annual effective tax rate are subject to significant variations due to several factors including variability in predicting our pre-tax and taxable income and the mix of jurisdictions to which those items relate, relative changes of expenses or losses for which tax benefits are not recognized, how we do business, and changes in law, regulations, and administrative practices. Our effective tax rate can be volatile based on the amount of pre-tax income. For example, the impact of discrete items on our effective tax rate is greater when pre-tax income is lower.

We assess the available positive and negative evidence to estimate whether we will generate sufficient future taxable income to use our existing deferred tax assets. We consider, among other things, our recent historical financial and operating results (three years of cumulative income and revenue growth during those periods), along with our forecasted growth rates, projected future taxable income, including the impact of any costs associated with our recent acquisition, and tax planning strategies. We perform multiple sensitivity analyses to address how potential changes in significant assumptions would impact our ability to generate the minimum amount of taxable income required. We give the most weight to objective evidence related to our more recent financial results. Based upon the level of historical taxable income and projections for future taxable income, including the impact of any acquisition costs, and planned tax strategies over the periods in which the deferred tax assets are deductible, we believe it is more likely than not that we will realize the benefits of these deduction differences, net of existing valuation allowances. However, it is possible that certain state tax credits could ultimately expire unused if estimates of future apportioned taxable income during the carryforward period are reduced.

We have not provided for U.S. income tax on certain foreign earnings because we intend to indefinitely reinvest these earnings outside the U.S. We have begun expansion of operations outside of the U.S. and have plans for additional expansion for which we have incurred and will continue to incur capital requirements. We have considered ongoing capital requirements of the parent company in the U.S.

We have tax deductions from stock-based compensation that exceed the stock-based compensation recorded for such instruments. To the extent such excess tax benefits are ultimately realized, they will increase shareholders' equity. We utilize the "with-and-without" approach in determining if and when such excess tax benefits are realized. Under this approach, excess tax benefits related to stock-based compensation are the last tax benefits to be realized.

### Earnings per share

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

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

	Three months ended September 30, 2016		2015		Nine months ended September 30, 2016		2015	
Net income (loss) attributable to stockholders of Overstock.com, Inc.	\$(3,098)	\$(2,071)	\$9,427	\$2,336				
Net income (loss) per common share—basic:								
Net income (loss) attributable to common shares—basic	\$(0.12 )	\$(0.08 )	\$0.37	\$0.10				
Weighted average common shares outstanding—basic	25,356	24,681	25,326	24,402				
Effect of dilutive securities:								
Stock options and restricted stock awards	—	—	62	111				
Weighted average common shares outstanding—diluted	25,356	24,681	25,388	24,513				
Net income (loss) attributable to common shares—diluted	\$(0.12 )	\$(0.08 )	\$0.37	\$0.10				

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

	Three months ended September 30, 2016		Nine months ended September 30, 2015	
Stock options and restricted stock units	765	566	536	262

## Stock repurchase program

On May 5, 2015, our Board of Directors authorized a stock repurchase program under which we may repurchase shares of our outstanding common stock for up to \$25 million at any time through December 31, 2017. To date, we have not made any repurchases under this program.

## Recently adopted accounting standards

In April 2015, the FASB issued ASU No. 2015-03, Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. We implemented the provisions of ASU 2015-03 on January 1, 2016. The prior period amounts related to this implementation have been reclassified to conform to the current period presentation and were not significant. The implementation of ASU 2015-03 did not impact our results of operations or cash flows.

## Recently issued accounting standards not yet adopted

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In July 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date for us of ASU No. 2014-09 to January 1, 2018. Early adoption of ASU No. 2014-09 is permitted, but not before its original effective date. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers - Principal versus Agent Considerations. This ASU

clarifies the implementation guidance for principal versus agent considerations in ASU No. 2014-09 and provides indicators that assist in the assessment of control. ASU No. 2016-08 is effective for us beginning January 1, 2018. In 2016, the FASB issued additional implementation guidance for the new revenue recognition standards. These standards permit the use of either the retrospective or cumulative effect transition method. We have initiated an assessment of our revenue streams and have developed an initial plan for implementing these standards. We have not yet selected a transition method nor have we completed our assessment of the effect that ASU No. 2014-09 will have on our consolidated financial statements and related disclosures.

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In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which requires inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard requires entities to apply this change prospectively to the measurement of inventory after the date of adoption. We do not intend to adopt the standard before the effective date and we do not expect that ASU No. 2015-11 will have a significant impact on our consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes, which requires that deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard requires entities to apply this change on either a prospective or retrospective basis for the periods presented. We do not intend to adopt the standard before the effective date and we expect to apply the standard prospectively. The adoption of this standard will cause us to reclassify our current deferred tax assets and liabilities to a single noncurrent amount in our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which, among other things, requires lessees to recognize most leases on their balance sheets related to the rights and obligations created by those leases. The new standard also requires new disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The new standard becomes effective for us on January 1, 2019. Early adoption is permitted. The amendments in this update should be applied under a modified retrospective approach. We are evaluating the effect that ASU No. 2016-02 will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-04, Liabilities - Extinguishment of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products, which specifies how prepaid stored-value product liabilities, such as gift cards, should be derecognized. The standard, among other things, requires derecognition of such liabilities through expected breakage in proportion to the pattern of rights expected to be exercised by the holder, but only to the extent that it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. The new standard becomes effective for us on January 1, 2018. Early adoption is permitted. The amendments in this update should be applied under a modified retrospective approach or a retrospective approach to each period presented. We are evaluating the effect that ASU No. 2016-04 will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-07, Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting, which eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by step basis as if the equity method had been in effect during all previous periods that the investment had been held. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard requires entities to apply this change prospectively. We do not expect that ASU No. 2016-07 will have a material impact on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard specifies various transition methods for the individual amendments in this Update. The adoption of this standard will primarily cause us to recognize additional deferred tax assets related to excess tax

benefits through a cumulative effect adjustment in retained earnings as of January 1, 2017. We are evaluating the effect that ASU No. 2016-09 will have on our consolidated financial statements and related disclosures.

### 3. ACQUISITIONS, GOODWILL, AND ACQUIRED INTANGIBLE ASSETS

As part of our Medici blockchain and fintech technology initiatives, during 2015, a subsidiary of tØ.com, Inc. (formerly Medici, Inc.) entered into a purchase agreement to acquire Cirrus Technologies LLC, a financial technology firm. In connection with the Cirrus Technology acquisition, a subsidiary of tØ.com also entered into an agreement to purchase SpeedRoute LLC and all of the outstanding membership interests not already owned by tØ.com in Pro Securities, LLC. Both SpeedRoute and Pro Securities were under common control with Cirrus Technologies by a party that holds a noncontrolling

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interest in tØ.com. SpeedRoute and Pro Securities are FINRA-registered broker dealers.

This acquisition closed in two parts. The Cirrus Technologies acquisition closed in Q3 2015 and the membership interests in SpeedRoute and Pro Securities closed in Q1 2016 after receiving approval from FINRA. The total gross purchase price of this acquisition was \$29.7 million, consisting of approximately \$11.6 million in cash (which excludes \$2.2 million in cash acquired, primarily during Q1 2016) and 908,364 shares of Overstock's common stock valued at approximately \$18.1 million. The proceeds for the acquisition were financed by tØ.com through a note payable to Overstock that bears interest that approximates the Federal Funds Rate. The total purchase price has been allocated to the assets acquired and the liabilities assumed based on their respective fair values at the acquisition dates, with amounts exceeding fair value recorded as goodwill. We did not record significant deferred taxes related to the acquisition. The goodwill of the acquired business is deductible for tax purposes.

The acquisition of Cirrus Technologies and the acquisition of the membership interests of SpeedRoute and Pro Securities were negotiated and contemplated in conjunction with each other. As such, this was recognized as a single transaction. We estimated the fair value of the acquired assets based on Level 3 inputs, which were unobservable (see Note 2—Accounting Policies, Fair value of financial instruments). These inputs included our estimate of future revenues, operating margins, discount rates, royalty rates and assumptions about the relative competitive environment.

The fair values of the assets acquired and liabilities assumed at the acquisition dates are as follows (in thousands):

Purchase Price	Fair Value
Cash paid, net of cash acquired	\$9,353
Common stock issued	18,149
	\$27,502
Allocation	
Goodwill	\$11,914
Intangibles	16,000
Accounts receivable and other assets	2,565
Other liabilities assumed	(2,977 )
	\$27,502

The following table details the identifiable intangible assets acquired at their fair value and useful lives (amounts in thousands):

Intangible Assets	Fair Value	Weighted Average Useful Life (years)
Technology and developed software	\$13,600	8.21
Customer relationships	1,900	4.83
Trade names	300	0.12
Other	200	
Total acquired intangible assets at the acquisition dates	16,000	
Less: accumulated amortization of acquired intangible assets	(4,599 )	
Total acquired intangible assets, net as of September 30, 2016	\$11,401	

The expense for amortizing acquired intangible assets in connection with this acquisition was \$1.0 million and \$3.2 million for the three and nine months ended September 30, 2016, respectively.

Acquired intangible assets primarily include technology, customer relationships and trade names. As described above, we determined the fair value of these assets using an income approach method to determine the present value of expected future cash flows for each identifiable intangible asset. This method was based on discount rates which

incorporate a risk premium to take into account the risks inherent in those expected cash flows. The expected cash flows were estimated using the expectations of market participants.

As a result of the closing of the membership interests in SpeedRoute and Pro Securities, and finalizing the valuation of the acquired assets, during the nine months ended September 30, 2016, we made a \$689,000 adjustment in goodwill consisting

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primarily of net cash acquired of \$1.2 million, accounts receivable and other assets of \$1.9 million and liabilities assumed of \$2.5 million.

The acquired assets, liabilities, and associated operating results were consolidated into our financial statements at the acquisition dates, or the dates on which we obtained control of the acquired assets or interests. The revenue and operating loss of the combined acquired entities included in our financial statements were \$3.9 million and \$3.0 million, respectively, for the three months ended September 30, 2016, and were \$10.5 million and \$9.2 million, respectively, for the nine months ended September 30, 2016.

The following unaudited pro forma financial information presents our results as if the acquisitions had occurred at the beginning of 2015 (amounts in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net revenues	\$441,564	\$397,339	\$1,274,957	\$1,181,270
Operating income (loss)	\$(5,047 )	\$(3,173 )	\$7,484	\$3,208

The unaudited pro forma financial information is not intended to represent or be indicative of our consolidated results of operations that would have been reported had the acquisition been completed during the periods indicated, nor should it be taken as indicative of our future consolidated results of operations.

#### 4. BORROWINGS

##### U.S. Bank term loan and revolving loan agreement

In October 2014, we entered into a syndicated senior secured credit facility (the "Facility") with U.S. Bank National Association ("U.S. Bank" or the "Administrative Bank") and certain other banks in connection with the construction of our new corporate headquarters (the "Project"). The Facility is governed by a Loan Agreement dated as of October 24, 2014 which provides for an aggregate credit amount of \$55.8 million, consisting of (i) a senior secured real estate loan of \$45.8 million (the "Real Estate Loan") to be used to finance a portion of the Project and (ii) a three-year \$10.0 million senior secured revolving credit facility (the "Revolving Loan") for working capital and capital expenditures, but not for the Project. The Real Estate Loan and the Revolving Loan are both secured by the Project, our inventory and accounts receivable, substantially all of our deposit accounts and related assets. We began borrowing under the facility in October 2015.

On or about January 1, 2017 (but no later than 90 days thereafter), the Real Estate Loan is designed to convert into an approximately 6.75-year term loan due October 1, 2023 (the "Term Loan"). The conditions to conversion of the Real Estate Loan to the Term Loan include, among others, requirements that the Project must have been completed in accordance with the applicable plans, paid for in full, and generally free of liens; completion must have been certified by the project architect and the inspecting architect; certificates of occupancy must have been issued; we must have paid all amounts then due to the lending banks and must be in compliance with the covenants under the Loan Agreement; the Real Estate Loan must be brought "in balance" as defined in the Loan Agreement, which may require us to contribute additional cash to the Project; we must have paid the final amount of our cash contribution as required by the Loan Agreement; and if required by the Administrative Bank, an updated appraisal must show that the Project is in compliance with an 80% loan to value ratio requirement. If the conditions to conversion are not satisfied, all amounts outstanding under the Facility will become immediately due and payable. In August 2016, the Project was substantially completed, we obtained a temporary certificate of occupancy and we began to occupy the building. We anticipate the Real Estate Loan to convert to the Term Loan on January 1, 2017 (but no later than 90 days thereafter).

Amounts outstanding under the Real Estate Loan and the Term Loan carry an interest rate based on one-month LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%. However, we have entered into interest rate swap agreements designed to fix our interest rate on the Real Estate Loan and the Term Loan at approximately 4.6% annually (see Derivative financial instruments in Note 2. Accounting Policies). Monthly payments of interest only will be due and payable on the Real Estate Loan prior to conversion. Following conversion, we are required to make monthly payments of principal estimated to be \$1.1 million annually plus interest, with a balloon payment of all unpaid principal (estimated to be \$38.0 million) and interest on

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October 1, 2023. Amounts outstanding under the Revolving Loan will carry an interest rate based on LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%.

We are required to maintain compliance as of the end of each calendar quarter with the following financial covenants:

- a fixed charge coverage ratio on a trailing 12-month basis of no less than 1.15 to 1.00;
- a cash flow leverage ratio on a trailing 12-month basis not greater than 3.00 to 1.00 during the Construction Phase (as defined in the Loan Agreement);
- a cash flow leverage ratio not greater than 2.50 to 1.00 following the Construction Phase; and
- minimum liquidity of at least \$50.0 million.

At September 30, 2016, we were in compliance with the financial covenants. In addition to the financial covenants described above, we are required to comply with a number of covenants relating to the Project and our business, including covenants limiting certain indebtedness. Notwithstanding, the Loan Agreement permits us to incur up to \$20.0 million of additional senior-secured indebtedness for equipment financing (as described under U.S. Bank master lease agreement below),

and other senior-secured indebtedness provided that the aggregate principal amount of such other senior-secured indebtedness does not exceed ten percent of our consolidated assets. The Loan Agreement includes customary events of default in addition to events of default relating specifically to the Project. The Real Estate Loan and the Revolving Loan are cross-defaulted and cross-collateralized. In the event of a default, the default rate of interest would be 2.00% above the otherwise applicable rate. Unless it terminates earlier or is extended with the consent of the Administrative Bank and all of the Banks, the Revolving Loan facility will terminate on October 24, 2017.

As of September 30, 2016, we had borrowed \$40.9 million under the Real Estate Loan. We have not borrowed any amounts under the Revolving Loan. Our liability under the Real Estate Loan approximates fair value. Amounts outstanding under the Real Estate Loan are presented net of discount and issuance costs in our consolidated balance sheets.

Future principal payments on the Facility as of September 30, 2016, are as follows (in thousands):

Payments due by period:

2016 (Remainder)	\$—
2017	1,145
2018	1,145
2019	1,145
2020	1,145
Thereafter	36,355
	\$40,935

#### U.S. Bank master lease agreement

In November 2015, we entered into a Master Lease Agreement and a Financial Covenants Rider (collectively, the "Master Lease Agreement") with U.S. Bank Equipment Finance, a division of U.S. Bank National Association ("Lessor"). Under the Master Lease Agreement we are able to sell certain assets (the "Leased Assets") to the Lessor and simultaneously lease them back for a period of 60 months. We are also able to finance certain software licenses (inclusive in the "Leased Assets") for a period of 60 months. We have the right to repurchase the Leased Assets and terminate the Master Lease Agreement twelve months following the initial term. We also have the right to repurchase the Leased Assets at the end of the term for \$1.00. Payments on the Master Lease Agreement are due monthly. During the nine months ended September 30, 2016, we received proceeds under the Master Lease Agreement of \$6.1 million. At September 30, 2016, our total outstanding liability under the Master Lease Agreement was \$10.3 million. The

average interest rate for amounts outstanding under the Master Lease agreement was approximately 3.50%.

We have accounted for the Master Lease Agreement as a financing transaction and amounts owed are included in Finance obligations, current and non-current in the consolidated balance sheets. We recorded no gain or loss as a result of this transaction. The Master Lease Agreement allows for lease financing of up to \$20 million. Our liability under the Master Lease Agreement approximates fair value.

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In connection with the Master Lease Agreement, and as long as any obligations remain outstanding under the Master Lease Agreement, we are required to maintain compliance with the same financial covenants as the Term Loan agreement with U.S. Bank described above. At September 30, 2016, we were in compliance with these financial covenants.

Future principal payments of finance obligations as of September 30, 2016, are as follows (in thousands):

Payments due by period:

2016 (Remainder)	\$553
2017	2,260
2018	2,339
2019	2,419
2020	2,399
Thereafter	345
	\$10,315

#### U.S. Bank letters of credit

At September 30, 2016 and December 31, 2015, letters of credit totaling \$430,000 were issued on our behalf collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets.

#### U.S. Bank commercial purchasing card agreement

We have a commercial purchasing card (the "Purchasing Card") agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At September 30, 2016, \$636,000 was outstanding and \$4.4 million was available under the Purchasing Card. At December 31, 2015, \$641,000 was outstanding and \$4.4 million was available under the Purchasing Card.

#### Capital leases

Fixed assets included assets under capital leases and finance obligations of \$16.2 million and \$10.0 million, at September 30, 2016 and December 31, 2015, respectively. Accumulated depreciation related to assets under capital leases and finance obligations was \$7.2 million and \$4.6 million, at September 30, 2016 and December 31, 2015, respectively.

Depreciation expense of assets recorded under capital leases was \$948,000 and \$218,000 for the three months ended September 30, 2016 and 2015, respectively, and \$2.4 million and \$632,000, for the nine months ended September 30, 2016 and 2015, respectively.

## 5. COMMITMENTS AND CONTINGENCIES

#### Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of September 30, 2016, are as follows (in thousands):

Payments due by period

2016 (Remainder)	\$2,479
2017	8,592
2018	6,359
2019	5,822

2020	4,038
Thereafter	24,513
	\$51,803

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Rental expense for operating leases totaled \$3.3 million and \$3.1 million for the three months ended September 30, 2016 and 2015, respectively, and \$10.1 million and \$9.4 million for the nine months ended September 30, 2016 and 2015, respectively.

## Legal Proceedings and Contingencies

From time to time, we are involved in litigation concerning consumer protection, employment, intellectual property and other commercial matters related to the conduct and operation of our business and the sale of products on our Website. In connection with such litigation, we may be subject to significant damages. In some instances other parties may have contractual indemnification obligations to us. However, such contractual obligations may prove unenforceable or non-collectible, and if we cannot enforce or collect on indemnification obligations, we may bear the full responsibility for damages, fees and costs resulting from such litigation. We may also be subject to penalties and equitable remedies that could force us to alter important business practices. Such litigation could be costly and time consuming and could divert or distract our management and key personnel from our business operations. Due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, results of operations, financial position, or cash flows.

On September 23, 2009, SpeedTrack, Inc. sued us along with 27 other defendants in the United States District Court in the Northern District of California. We are alleged to have infringed a patent covering search and categorization software. We believe that certain third party vendors of products and services sold to us are contractually obligated to indemnify us, and we have tendered defense of the case to an indemnitor who accepted the defense. On April 21, 2016, the court entered an order partially dismissing the claims against us. On May 4, 2016, the plaintiff filed an amended complaint, and in response, we have filed a motion requesting the court to dismiss the remaining claims against us. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On September 29, 2010, a trustee in bankruptcy filed an adversary proceeding against us in the matter of In re: Petters Company, Inc., a case filed in United States Bankruptcy Court, in the District of Minnesota. The complaint alleges principal causes of action against us under various Bankruptcy Code sections and the Minnesota Fraudulent Transfer Act, to recover damages for alleged transfers of property from the Petters Company occurring prior to the filing of the case initially as a civil receivership in October 2008. The trustee's complaint alleges such transfers occurred in at least one note transaction whereby we transferred at least \$2.3 million and received in return transfers totaling at least \$2.5 million. The case is in its discovery stages. Both parties have filed motions for summary judgment and are waiting for the court to hear the motions. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We intend to vigorously defend this action.

On November 17, 2010, we were sued in the Superior Court of California, County of Alameda, by District Attorneys for the California Counties of Alameda, Marin, Monterey, Napa, Santa Clara, Shasta and Sonoma County, and the County of Santa Cruz later joined the suit. The district attorneys sought damages and an injunction under claims for violations of California consumer protection laws, alleging we made untrue or misleading statements concerning our pricing, price reductions, sources of products and shipping charges. The complaint asked for damages in the amount of not less than \$15.0 million. We tried the case in September 2013 before the judge of the court and made final arguments in December 2013. On January 3, 2014, the court issued a tentative ruling in favor of the District Attorneys, which became a final Statement of Decision on February 5, 2014. The decision provides for an injunction that prescribes disclosures necessary for certain types of price advertising and price reductions and imposes civil penalties of \$3,500 per day for practices from March 2006 through September 2008, and \$2,000 per day for September 2008 through September 2013, totaling \$6.8 million. The court issued a final judgment February 19, 2014 reflecting the Court's Statement of Decision. We have stipulated to Plaintiff's reimbursement of costs in the amount of

\$111,500. We have appealed the decision and have secured a bond as required in the ruling in the amount of 150% of the penalty imposed in the matter until the ruling on the appeal. The appeal is briefed. No date has been set for oral argument. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We intend to continue to vigorously pursue the appeal and defend this action.

On February 11, 2013, RPost Holdings, Inc., RPost Communications Limited, and RMail Limited, filed suit against us in the United States District Court in Eastern District of Texas for infringement of patents covering products and services that verify the delivery and integrity of email messages. We tendered defense of the case to an indemnitor who accepted the defense. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no



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estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

In June 2013, William French filed suit against us and 46 other defendants under seal in the Superior Court of the State of Delaware. The filing was unsealed on March 24, 2014. French brought the action on Delaware's behalf for violations of Delaware's unclaimed property laws and for recovery of the unredeemed gift card value allegedly attributable to Delaware residents. French's complaint alleges that we, and other defendants, knowingly refused to fulfill obligations under Delaware's Abandoned Property Law by failing to report and deliver unclaimed gift card funds to the State of Delaware, and knowingly made, used or caused to be made or used, false statements and records to conceal, avoid or decrease an obligation to pay or transmit money to Delaware in violation of the Delaware False Claims and Reporting Act. The complaint seeks an injunction, monetary damages (including treble damages) penalties, and attorney's fees and costs. We, along with others, filed motions to dismiss the case. The court dismissed one count, but allowed one count to remain. The case is in its discovery stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above.

On September 18, 2015, we received a Tax Assessment from the Department of Revenue of the State of Washington asserting that we had nexus with Washington during the period January 1, 2008 to May 31, 2015 and assessing approximately \$31.5 million in taxes, interest, and/or penalties asserted to be due, subject to future field verification by the Department of Revenue, for the period. We recently received an additional Tax Assessment for the period of June 2015 through November 2015 in the amount of approximately \$2.5 million in taxes, interest and/or penalties. The nature of the loss contingencies relating to the assessment is described above. However, no estimate of the loss or range of loss can be made. We do not believe that we had nexus in Washington during the alleged period and, while we have engaged in some discussion with the State of Washington, we intend to vigorously contest this administrative action.

On April 28, 2016, the State of South Dakota sued us along with three other defendants in the Sixth Judicial Circuit Court of South Dakota. South Dakota alleges that U.S. constitutional law should be revised to permit South Dakota to require out-of-state ecommerce websites to withhold and remit sales tax in South Dakota. We have removed the case to the United States District Court. Pursuant to the statute, we would not be required to withhold and remit sales tax until there was verdict in favor of South Dakota which was then upheld by the highest applicable appellate court. The statute also would not require us to pay sales tax retroactively if we were to lose.

In September 2016, we received a letter from the District Attorney of Sonoma County, California who is acting as part of the Consumer Protection Divisions of the following counties in California: Sonoma, Alameda, Monterey, Napa, Solano, Fresno, Sacramento, Shasta, Santa Cruz, Butte, and Merced. The District Attorney alleges that certain plastic products on our site which are labeled as biodegradable, degradable, or decomposable constitute false advertising under California law. The District Attorney has requested documentation from us regarding this claim and we are cooperating. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this matter and pursue our indemnification rights with our vendors.

We establish liabilities when a particular contingency is probable and estimable. At September 30, 2016, we have accrued \$9.5 million in light of probable and estimable liabilities. It is reasonably possible that the actual losses may exceed our accrued liabilities. We have other contingencies which are reasonably possible; however, the reasonably possible exposure to losses cannot currently be estimated.

## 6. INDEMNIFICATIONS AND GUARANTEES

During our normal course of business, we have made certain indemnities, commitments, and guarantees under which we may be required to make payments in relation to certain transactions. These indemnities include, but are not limited to, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, the environmental indemnity we entered into in favor of the lenders under our Loan Agreement with U.S. Bank and other banks, and indemnities to our directors and officers to the maximum extent permitted under the laws of the State of Delaware. The duration of these indemnities, commitments, and guarantees varies, and in certain cases, is indefinite. In addition, the majority of these indemnities, commitments, and guarantees do not provide for any limitation of the maximum potential future payments we could be obligated to make. As such, we are unable to estimate with any reasonableness our potential exposure under these items. We have not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. We do, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable.

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## 7. STOCK-BASED AWARDS

We have equity incentive plans that provide for the grant to employees of stock-based awards, including stock options and restricted stock. During the three and nine months ended September 30, 2016, the Compensation Committee of the Board of Directors approved grants of 9,510 and 515,946 restricted stock awards, respectively, to our officers, board members and employees. The restricted stock awards vest over three years at 33.3% at the end of the first year, 33.3% at the end of the second year and 33.3% at the end of the third year and are subject to the employee's continuing service to us. At September 30, 2016, there were 560,000 unvested restricted stock awards that remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is either recognized on a straight line basis over the three-year vesting schedule or on an accelerated schedule when vesting of restricted stock awards exceeds a straight-line basis. The cumulative amount of compensation expense recognized at any point in time is at least equal to the portion of the grant date fair value of the award that is vested at that date. The weighted average grant date fair value of restricted stock awards granted during the three and nine months ended September 30, 2016 was \$16.63 and \$14.52, respectively.

Stock-based compensation expense related to restricted stock awards was \$1.4 million and \$839,000 during the three months ended September 30, 2016 and 2015, respectively. During the nine months ended September 30, 2016 and 2015, stock-based compensation expense related to restricted stock awards was \$4.1 million and \$2.6 million, respectively. During Q3 2016, we accelerated the vesting of certain restricted stock awards as part of employee separation agreements.

The following table summarizes restricted stock award activity during the nine months ended September 30, 2016 (in thousands):

	Nine months ended September 30, 2016	Weighted Average Grant Date Fair Value
Outstanding—beginning of year	349	\$ 24.80
Granted at fair value	516	14.52
Vested	(212)	22.60
Forfeited	(93)	16.25
Outstanding—end of period	560	\$ 17.58

## 8. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 Segment Reporting. Segments were determined based on how we manage the business, which, in our view, consists primarily of our Retail and Medici businesses. Our Retail business consists of our Direct and Partner segments, and the Medici business is included in Other. Although the Direct and Partner segments both relate to our Retail business, we do not combine these segments because they have dissimilar economic characteristics, such as gross profit margins. We do not allocate operating expenses for our Direct and Partner segments below gross profit, which is the measure we use to determine our reportable segments. Because we use gross profit to determine our reportable segments, our Medici business is not

significant as compared to our other segments. We evaluate the performance of our segments and allocate resources to them based primarily on gross profit. There were no significant inter-segment sales or transfers during the three and nine months ended September 30, 2016 and 2015.

The table below summarizes information about our reportable segments for the three and nine months ended September 30, 2016 and 2015 (in thousands):

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	Three months ended September 30,				Nine months ended September 30,			
	Direct	Partner	Other	Total	Direct	Partner	Other	Total
2016								
Revenue, net	\$24,620	\$413,019	\$3,925	\$441,564	\$75,901	\$1,187,364	\$10,516	\$1,273,781
Cost of goods sold	23,955	335,306	2,587	361,848	72,459	961,227	6,750	1,040,436
Gross profit	\$665	\$77,713	\$1,338	\$79,716	\$3,442	\$226,137	\$3,766	\$233,345
Operating expenses				84,763				226,088
Interest and other income, net				1,112				9,408
Provision (benefit) for income taxes				(543 )				8,178
Consolidated net income (loss)				\$(3,392 )				\$8,487
2015								
Revenue, net	\$33,621	\$357,590	\$—	\$391,211	\$104,184	\$1,073,384	\$—	\$1,177,568
Cost of goods sold	31,989	286,771	—	318,760	95,751	860,272	—	956,023
Gross profit	\$1,632	\$70,819	\$—	\$72,451	\$8,433	\$213,112	\$—	\$221,545
Operating expenses				75,822				218,990
Interest and other income, net				739				2,576
Provision (benefit) for income taxes				(15 )				3,774
Consolidated net income (loss)				\$(2,617 )				\$1,357

The direct segment includes revenues, direct costs, and cost allocations associated with sales of inventory we own. Costs for this segment include product costs, freight, warehousing and fulfillment costs, credit card fees and customer service costs.

The partner segment includes revenues, direct costs and cost allocations associated with sales of inventory owned by our partners. Costs for this segment include product costs, outbound freight and fulfillment costs, credit card fees and customer service costs.

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

For the three and nine months ended September 30, 2016 and 2015, substantially all of our sales revenues were attributable to customers in the United States. At September 30, 2016 and December 31, 2015, substantially all of our fixed assets were located in the United States.

## 9. BROKER DEALERS

As part of our Medici blockchain and fintech technology initiatives, we hold a controlling interest in each of two broker dealers, SpeedRoute LLC ("SpeedRoute") and Pro Securities LLC ("Pro Securities"), which we acquired in January 2016 (see Note 3. Acquisitions).

SpeedRoute is an electronic, agency-only FINRA-registered broker dealer that provides connectivity for its customers to U.S. equity exchanges as well as off-exchange sources of liquidity such as dark pools. All of SpeedRoute's customers are registered broker dealers. SpeedRoute also does not hold, own or sell securities.

Pro Securities is a FINRA-registered broker dealer that owns and operates the Pro Securities alternative trading system ("ATS"), which is registered with the SEC. An ATS is a trading system that is not regulated as an exchange, but is a licensed venue for matching buy and sell orders. The Pro Securities ATS is a closed system available only to its broker dealer subscribers. Pro Securities does not accept orders from non-broker dealers, nor does it hold, own or sell securities.

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SpeedRoute and Pro Securities are subject to the SEC's Uniform Net Capital Rule (SEC Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1 and that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At September 30, 2016, SpeedRoute had net capital of \$1,098,634, which was \$970,503 in excess of its required net capital of \$128,131 and SpeedRoute's net capital ratio was 1.8 to 1. At September 30, 2016, Pro Securities had net capital of \$40,091, which was \$35,091 in excess of its required net capital of \$5,000 and Pro Securities net capital ratio was 0.14 to 1.

During the three months ended September 30, 2016, SpeedRoute incurred commission expense to Pro Securities in the amount of \$45,000. During the nine months ended September 30, 2016, the amount incurred was \$135,000. During the three months ended September 30, 2016, SpeedRoute paid technological related services, rent and managerial support to a related entity in the amount of \$886,500. During the nine months ended September 30, 2016, the amount paid was \$2.8 million.

SpeedRoute and Pro Securities did not have any securities owned or securities sold, not yet purchased at September 30, 2016.

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

Special Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q and the documents incorporated herein by reference, as well as our other public documents and statements our officers and representatives may make from time to time, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. 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. The forward-looking statements include all statements other than statements of historical fact, including, without limitation, all statements regarding:

- the anticipated benefits and risks of our business and plans;
- our beliefs regarding our ability to attract and retain customers in a cost-efficient manner;
- the anticipated effectiveness of our marketing;
- our future operating and financial results, including any projections of revenue, profits or losses, contribution, technology expense, general and administrative expense, cash flow, capital expenditures or other financial measures or amounts or non-GAAP financial measures or amounts or anticipated changes in any of them;
- our plans and expectations regarding our new corporate headquarters near Salt Lake City, Utah;
- our beliefs and expectations regarding the adequacy of our office and warehouse;
- our expectations regarding the benefits and risks of the credit facility we entered into for the purpose of, among other things, financing a portion of the costs of our new corporate headquarters;
- our future capital requirements and our ability to satisfy our capital needs;
- our expectations regarding the adequacy of our liquidity;
- our ability to retire or refinance any debt we may have or incur in the future;
- the competition we currently face and will face in our business as the ecommerce business continues to evolve and to become more competitive, and as additional competitors, including competitors based in China or elsewhere, continue to increase their efforts in our primary markets;
- the effects of government regulation;
- our plans for international markets, our expectations for our international sales efforts and the anticipated results of our international operations;
- our plans and expectations regarding Supplier Oasis and our efforts to provide multi-channel fulfillment services;
- our plans and expectations regarding our insurance product offerings and consumer finance offerings;
- our plans for further changes to our business;
- our beliefs regarding current or future litigation or regulatory actions;
- our beliefs regarding the costs and benefits of our "spend and defend" policy under which we generally refuse to settle abusive patent suits brought against us;
- our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business including the assessments we have received from the Department of Revenue of the State of Washington;
- our beliefs regarding the adequacy of our insurance coverage;
- our beliefs regarding the adequacy and anticipated functionality of our infrastructure, including our backup facilities and beliefs regarding the adequacy of our disaster planning and our ability to recover from a disaster or other interruption of our ability to operate our website at its highest level of functionality;
- our beliefs regarding our cybersecurity efforts and measures and our efforts to prevent data breaches and the costs we will incur in our ongoing efforts to avoid interruptions to our product offerings and other business processes from cyber attacks and from data breaches;
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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 beliefs regarding the adequacy of our order processing systems and our fulfillment and distribution capabilities;

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our expectations regarding the costs and benefits of our other businesses, innovations and projects including our new and used car listing service, our Worldstock Fair Trade offerings, our Main Street Revolution offerings and our ecommerce marketplace channel offerings;

our expectations regarding the costs, benefits and risks of our efforts to develop blockchain and fintech technology and of the costs, benefits and risks of our recent acquisitions of the assets and operations of a financial technology company and two registered broker dealers affiliated with the fintech business;

our expectations regarding the costs and benefits of various programs we offer, including Club O and programs pursuant to which we offer free or discounted participation in Club O or other programs we offer to members of the United States Armed Forces and/or to full-time, post-secondary students or others, and including our community site and our public service pet adoption program;

our expectations regarding the costs and benefits of transitioning some of our marketing efforts from coupons to rewards for our Club O members;

our belief that we and our partners will be able to maintain inventory levels at appropriate levels despite the seasonal nature of our business;

- our belief that our sales through other ecommerce marketplace channels will be successful and will become an important part of our business; and

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

Further, in some cases, you can identify forward-looking statements by terminology such as may, will, could, should, likely, expect, plan, seek, intend, anticipate, project, believe, estimate, predict, potential, goal, strategy, future or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those contemplated by forward-looking statements for a variety of reasons, including among others:

- changes in U.S. and global economic conditions and consumer spending;

- any downturn in the U.S. housing industry;

- world events;

- the rate of growth of the Internet and online commerce, and the occurrence of any event that would discourage or prevent consumers from shopping online or via mobile apps;

- any failure to maintain our existing relationships or build new relationships with partners on acceptable terms;

- any difficulties we may encounter maintaining optimal levels of product quality and selection or in attracting sufficient consumer interest in our product offerings;

- any difficulties we may have with the quality or safety of the products we offer;

- modifications we may make to our business model from time to time, including aspects relating to our product mix and the mix of direct/partner sourcing of the products we offer;

- the mix of products purchased by our customers;

- any problems we may have with cyber security or data breaches or Internet or other infrastructure or communications impairment problems or the costs of preventing or responding to any such problems;

- any problems with or affecting our credit card processors, including cyber-attacks, Internet or other infrastructure or

- communications impairment or other events that could interrupt the normal operation of the credit card processors or any difficulties we may have maintaining compliance with the rules of the credit card processors;

- any problems we may encounter as a result of the implementation in the U.S. of the EMV (Europay, MasterCard and Visa) standards for credit cards, which generally became effective in the U.S. in 2015, including any problems that may result from any increase in online fraud as a result of the implementation of the EMV standards;

- problems with or affecting the facility where substantially all of our computer and communications hardware is located or other problems that result in the unavailability of our Website or reduced performance of our transaction systems;

- difficulties we may have in responding to technological changes;

- problems with the large volume of fraudulent purchase orders we receive on a daily basis;

problems we may encounter as a result of the listing or sale of pirated, counterfeit or illegal items by third parties;  
difficulties we may have financing our operations or our expansion with either internally generated funds or external sources of financing;

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any environmental or other difficulties we may encounter relating to the real estate we recently purchased; any difficulties we encounter with our new corporate headquarters, our financing of a substantial portion of the costs of our new headquarters or the interest rate swaps we entered into in connection with the financing;

any difficulties we may encounter in connection with Supplier Oasis or our efforts to provide multi-channel fulfillment services, our Farmers Market offerings, our insurance product offerings, our consumer finance offerings or other businesses or product or service offerings outside of our main shopping website offerings;

any difficulties we may encounter as a result of our reliance on third parties that we do not control for the performance of critical functions material to our business;

any difficulties we may encounter in connection with the rapid shift of ecommerce and online payments to mobile and multi-channel commerce and payments;

the extent to which we owe income or sales taxes or are required to collect sales taxes or report sales or to modify our business model in order to avoid being required to collect sales taxes or report sales or avoid the application of other types of taxes;

any difficulties we may encounter as a consequence of accepting or holding bitcoin or other cryptocurrencies, whether as a result of regulatory, tax or other legal issues, technological issues, value fluctuations, lack of widespread adoption of bitcoins or other cryptocurrencies as an acceptable medium of exchange or otherwise;

increasing competition, including competition from well-established competitors including Amazon.com, competition from competitors based in China or elsewhere, competition from companies willing to incur substantial losses in order to build market share, and from others including competitors with business models that may include delivery capabilities that we may be unable to match;

difficulties with the management of our growth and any periods in which we fail to grow in accordance with our plans;

fluctuations in our operating results;

difficulties we may encounter in connection with our efforts to expand internationally;

difficulties we may encounter in connection with our efforts to offer additional types of services to our customers, including insurance products and consumer financing;

difficulties, including expense and any operational or regulatory issues we may encounter in connection with the integration or operation of the assets and operations of the financial technology company and two registered broker dealers affiliated with the fintech business that we recently acquired;

technical, operational, regulatory or other difficulties we may encounter in connection with our efforts to develop blockchain and fintech technology, or with the operation of tØ.com's system for the trading of securities;

difficulties we may encounter with our Medici blockchain and fintech technology initiatives due to lack of market acceptance or as a result of competition from any of the numerous other competitors seeking to develop competing technologies or systems or as a result of patents that may be granted to other companies or persons;

any impairment we may recognize with respect to assets or businesses that we have acquired or may acquire;

any impairment we may recognize with respect to our investments in companies that are in the startup or development stages;

any liability or expense we may incur as a result of our investments in other companies, whether as a result of regulatory issues or otherwise;

the outcomes of legal proceedings, investigations and claims, including, the outcome of the assessments we have received from the Department of Revenue of the State of Washington;

any difficulties we have optimizing our warehouse operations;

risks of inventory management and seasonality;

the cost and availability of traditional and online advertising, the rapid changes in the online advertising business and the longer-term changes in the traditional advertising business, and the results of our various brand building and marketing campaigns;

risks that the amount of deferred tax assets we consider realizable could be reduced if estimates of future taxable income during the carryforward period are reduced; and

the other risks described in this report or in our other public filings.

In evaluating all forward-looking statements, you should specifically consider the risks outlined above and in this Quarterly Report on Form 10-Q in Part II, Item 1A under the caption "Risk Factors," in Part I, Item 2 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Part II, Item 1 under the caption "Legal Proceedings," and elsewhere in this report. These factors may cause our actual results to differ materially from

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those contemplated by any forward-looking statement. Although we believe that our expectations reflected in the forward-looking statements are reasonable, we cannot guarantee or offer any assurance of future results, levels of activity, performance or achievements or other future events.

Our forward-looking statements contained in this report speak only as of the date of this report and, except as required by law, we undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report or any changes in our expectations or any change in any events, conditions or circumstances on which any of our forward-looking statements are based.

## Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other 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 the Investor Relations section of our main website [www.overstock.com](http://www.overstock.com) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our Internet Website and the information contained therein or connected thereto are not a part of or incorporated into this Quarterly Report on Form 10-Q.

## Overview

We are an online retailer offering a broad range of price-competitive brand name, non-brand name and closeout products, including furniture, home decor, bedding and bath, housewares, jewelry and watches, apparel and designer accessories, health and beauty products, electronics and computers, and sporting goods, among other products. We also sell hundreds of thousands of best seller and current run books, magazines, CDs, DVDs and video games ("BMMG"). We sell these products and services through our Internet websites located at [www.overstock.com](http://www.overstock.com), [www.o.co](http://www.o.co) and [www.o.biz](http://www.o.biz) (referred to collectively as the "Website"). Although our three websites are located at different domain addresses, the technology and equipment and processes supporting the Website and the process of order fulfillment described herein are the same for all three websites.

Our company, based near Salt Lake City, Utah, was founded in 1997. We launched our initial website in March 1999 and were re-incorporated in Delaware in 2002. As used herein, "Overstock," "Overstock.com," "O.co," "we," "our" and similar terms include Overstock.com, Inc. and its consolidated subsidiaries, unless the context indicates otherwise.

We deal primarily in price-competitive, new, replenishable and closeout merchandise and use the Internet to aggregate both supply and demand to create an efficient marketplace for selling these products. We provide our customers an opportunity to conveniently shop for a broad range of price-competitive products. We continually add new, and sometimes limited, inventory to our Website in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We provide suppliers with access to a large customer base and convenient services for order fulfillment, customer service, returns handling, and other services. The merchandise offered on our Website is from a variety of sources including well-known, brand-name manufacturers. We have organized our shopping business (sales of product offered through the Shopping Section of our Website) into two principal segments—a "direct" business and a "partner" business. Consumers and businesses are able to access and purchase our products 24 hours a day from the convenience of a computer, Internet-enabled mobile telephone or other Internet-enabled device. Our team of customer service representatives assists customers by telephone, instant online chat and e-mail. We also derive revenue from other businesses advertising products or services on our Website. Our sales are primarily to customers located in the United States.

Our direct business includes sales made to individual consumers and businesses from our owned inventory and that are fulfilled primarily from our warehouse in Salt Lake City, Utah. For our partner business, we sell merchandise from

manufacturers, distributors and other suppliers ("partners") primarily through our Website. We are considered to be the primary obligor for the majority of these sales transactions and we record revenue from the majority of these sales transactions on a gross basis. Our use of the term "partner" does not mean that we have formed any legal partnerships with any of our partners. These third party partners generally perform the same fulfillment operations as our warehouses, such as order picking and shipping; however, we handle returns and customer service related to substantially all orders placed through our Website. Revenue generated from sales on our Shopping site from both the direct and partner businesses is recorded net of returns, coupons and other discounts.

In late 2014, we began working on initiatives to develop blockchain and fintech technology which we refer to collectively as Medici and which includes our majority owned subsidiary tØ.com, Inc. (formerly Medici, Inc.). In Q1 2016, we

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completed the acquisition of a financial technology company and two related registered broker-dealers as part of this initiative, and we are currently working on several financial applications of blockchain technology.

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### 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 or incorporated in this report. This executive commentary includes forward-looking statements, and investors are cautioned to read “Special Cautionary Note Regarding Forward-Looking Statements.”

Revenues in Q3 2016 increased 13% compared to Q3 2015. The growth in revenue was primarily due to a 10% increase in orders, coupled with a 5% increase in average order size. These increases were partially offset by increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions. Our average order size has increased in recent years due primarily to a sales mix shift into home and garden products. We are uncertain how long this trend will continue.

Gross profit in Q3 2016 increased 10% compared to Q3 2015 primarily as a result of revenue growth. Gross margin decreased to 18.1% in Q3 2016 compared to 18.5% in Q3 2015. The decrease in gross margin was primarily due to increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions, partially offset by a continued shift in sales mix into higher margin home and garden products.

Sales and marketing expenses as a percentage of revenue increased from 7.7% to 7.9% during Q3 2016 as compared to the same period in 2015, primarily due to increased spending in the sponsored search marketing channels and increased staff related costs, partially offset by lower television marketing spend.

As a result of these factors, our Contribution increased 12% in Q3 2016 compared to Q3 2015 (see Non-GAAP Financial Measures below for a reconciliation of Contribution to Gross Profit). Contribution margin of 11.1% in Q3 2016 compared to 11.2% in Q3 2015.

Technology expenses in Q3 2016 increased \$1.7 million compared to Q3 2015, primarily due to an increase in depreciation and amortization of \$1.6 million.

General and administrative expenses in Q3 2016 increased \$2.6 million compared to Q3 2015, primarily due to an increase of \$3.4 million in staff related costs and \$1.1 million in bad debt expense for accounts receivable due from an international marketplace in which we also have a minority investment. These increases were partially offset by a \$2.2 million decrease in legal fees.

During Q3 2016, we recognized an impairment charge of \$2.9 million in Other income, net related to an international marketplace company in which we hold a minority investment that has historically been recorded at cost.

In Q1 2016, we entered into a settlement agreement in our prime broker litigation which concluded the litigation in its entirety and we recognized settlement proceeds of \$19.5 million. Related costs associated with the litigation and settlement of approximately \$1.0 million were included in G&A expenses during Q1 2016.

As part of our Medici initiatives to develop blockchain and fintech technology, in Q1 2016, we completed the acquisition of two registered broker-dealers. In 2015 we acquired a related financial technology company.

We continue to seek opportunities for growth, through our Medici blockchain and fintech technology initiatives and other means. As a result of these initiatives, we may continue to incur additional expenses. We may also make investments in, or acquisitions of other technologies and businesses. These expenses, acquisitions or investments may be material, and, coupled with the seasonality of our business, may lead to reduced income or to losses in some periods, and to reduced liquidity.

During Q3 2016, we substantially completed the construction of our new corporate headquarters near Salt Lake City, Utah. We estimate that the total project will cost approximately \$99.2 million and as of September 30, 2016 we have incurred approximately \$95.1 million in costs toward the project. We began to occupy the building in August 2016. The construction project and related financing is discussed in further detail in the Liquidity and Capital Resources, Borrowings section below.

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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.

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## Results of Operations

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

	Three months ended September 30, 2016		2015		Nine months ended September 30, 2016		2015	
	(as a percentage of total net revenue)		(as a percentage of total net revenue)		(as a percentage of total net revenue)		(as a percentage of total net revenue)	
Revenue, net								
Direct	5.6	%	8.6	%	6.0	%	8.8	%
Partner and other	94.4		91.4		94.0		91.2	
Total net revenue	100.0		100.0		100.0		100.0	
Cost of goods sold								
Direct	5.4		8.2		5.7		8.1	
Partner and other	76.5		73.3		76.0		73.1	
Total cost of goods sold	81.9		81.5		81.7		81.2	
Gross profit	18.1		18.5		18.3		18.8	
Operating expenses:								
Sales and marketing	7.9		7.7		7.8		7.3	
Technology	6.1		6.4		6.1		6.1	
General and administrative	5.3		5.3		5.3		5.1	
Litigation settlement	—		—		(1.5)	)	—	
Total operating expenses	19.2		19.4		17.7		18.6	
Operating income (loss)	(1.1)	)	(0.9)	)	0.6		0.2	
Other income, net	0.3		0.2		0.7		0.2	
Income (loss) before income taxes	(0.9)	)	(0.7)	)	1.3		0.4	
Provision (benefit) for income taxes	(0.1)	)	—		0.6		0.3	
Consolidated net income (loss)	(0.8)	)%	(0.7)	)%	0.7	%	0.1	%

Comparisons of Three Months Ended September 30, 2016 to Three Months Ended September 30, 2015, and Nine Months Ended September 30, 2016 to Nine Months Ended September 30, 2015

## Revenue

The following table reflects our net revenues for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change
Revenue, net								
Direct	\$24,620	\$33,621	\$(9,001)	(26.8)%	\$75,901	\$104,184	\$(28,283)	(27.1)%
Partner and other	416,944	357,590	59,354	16.6	1,197,880	1,073,384	124,496	